Supreme Court, U.S.
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No. 95-

In The Supreme Court of the United States

OCTOBER TERM, 1995

EDWARD L. MORRIS,

Petitioner

v.

UNITED STATES OF AMERICA,

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in holding that, on a direct appeal challenging the sufficiency of evidence supporting a jury verdict of guilty, a reviewing court is required to resolve all factual issues in favor of the prosecution.

2. Whether the doctrine of proximate cause applies to: (a) the determination of whether a "scheme to defraud" has been committed under the mail and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343; and (b) the calculation of "loss" from fraud under USSG § 2F1.1.

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PETITION FOR A WRIT OF CERTIORARI

Edward L. Morris petitions for a writ of certiorari to review the judgment in this case of the United States Court of Appeals for the Seventh Circuit.[1]

OPINIONS BELOW

The opinion of the court of appeals is reported at 80 F.3d 1151. App. 1a-47a. Excerpts from the transcript of the district court's oral sentencing opinion are reproduced at App. 48a-60a.

JURISDICTION

The judgment of the court of appeals was entered on April 2, 1996. A petition for rehearing was denied on May 1, 1996. App. 61a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves the following statutory and regulatory provisions set out at App. 62a-65a: 18 U.S.C. §§ 1341 and 1343; 28 U.S.C. § 994; and USSG §§ 1B1.3 and 2F1.1.

STATEMENT OF THE CASE

On November 19, 1992, petitioner and Steven M. Gardner were indicted in the United States District Court for the Southern District of Illinois on two counts of mail fraud under 18 U.S.C. § 1341 and one count of wire fraud under 18 U.S.C. § 1343. (Morris and Gardner are hereinafter referred to

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[1] The caption of the case contains the names of all the parties.

as "Defendants.") That court had subject matter jurisdiction under 18 U.S.C. § 3231. A jury returned guilty verdicts against Defendants on all counts on November 10, 1993. On July 8, 1994, the district court sentenced each Defendant to a term of 46 months imprisonment. That court denied *Brady* and new trial motions on December 19, 1994. The court of appeals affirmed the convictions and sentences.[2]

1. From October 1987 to March 1988, Germania Bank, a federally insured, St. Louis area thrift institution, raised nearly $16 million in capital through the sale of subordinated notes. Morris, chairman and chief executive officer of Germania, originated the idea of raising capital in this way and provided overall leadership to the task.

The Government alleged in the indictment that the sales to consumers were fraudulent because Germania's reserves for loan losses were inadequate. A review of Germania's loan portfolio, completed shortly before the note sale began (known in the case as the "September Analysis"), indicated that over the next three years Germania should expect to add $1.2 million in "specific reserves" (reserves for anticipated losses on specific loans) and $8.1 million in "general" or "basket reserves" (reserves for anticipated losses on the overall loan portfolio).[3] Germania then set aside the $1.2 million in specific reserves, but not the $8.1 million in general reserves. The Government charged that Defendants agreed that Germania should expect

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[2] Defendants and another defendant, Joseph L. Mason, have been indicted and face trial on similar charges in the Eastern District of Missouri. See *United States v. Gardner*, 65 F.3d 82 (8th Cir. 1995), *cert. denied* 116 S.Ct. 748 (1996).

[3] A loan loss reserve is an "account set up by a bank based on its expectations of future loan losses. As [actual] losses occur [in the future], they are charged against this reserve." *Shapiro v. UJB Financial Corp.*, 964 F.2d 272, 281 (3rd Cir.) (quoting American Bankers Association, *Banking Terminology* 215 (1989)), *cert. denied*, 506 U.S. 934 (1992). Generally, loss reserves are "cushions" for losses over and above a bank's capital.

the $8.1 million in future loan losses, but that they failed to cause the thrift to set aside such reserves at that time because to do so could have delayed the note sale by forcing Germania to report a large quarterly loss. App. 8a-13a. The Government further alleged that the offering circular for the note sale was fraudulent because it asserted that "based on [Germania's] present analysis, adequate provision has been made for estimated losses from [loan] portfolios." App. 8a, 29a.

2. The Government's primary witness at trial, Jimmie W. New, was Germania's chief financial officer during the note sale. New supervised and compiled the September Analysis as part of "Project 90," a planning effort ordered by Morris to prepare the institution comprehensively for 1990. Tr. 383-88, 494-96. Testifying under a plea bargain, New stated that "we did have a set goal to reach a certain level of reserves by 1990." Tr. 384. He testified that at a management meeting with Defendants on September 22, 1987, they agreed with him "to recommend to [Germania's] executive committee" an overall "expected" loss figure for the loan portfolio of $18.7 million. Tr. 389-90, 392, 403. New did not state that his agreement with Defendants called for setting aside the basket reserves in September 1987. App. 383-404. New testified that shortly after he began discussing the Analysis at an executive committee meeting on September 26, 1987, Joseph L. Mason, Germania's controlling shareholder and New's former employer, heatedly objected to "taking any additional baskets at this time," citing doubts as to the report's accuracy as well as potential delays of the note sale and drops in Germania's stock price. Tr. 329-30, 395-400. The committee decided to take at that time reserves for specific losses expected in the Analysis, but not the general reserves. Tr. 400-04.

The case was tried under an order in limine, issued on the Government's motion, that barred evidence of certain events after the end of the note sale in March 1988. The order excluded evidence of "[t]he 1989 Financial Institutions Reform,

Recovery and Enforcement Act ('FIRREA') and changes in capital and accounting standards resulting therefrom," including the impact of those changes on Germania. Order in Limine, Sept. 8, 1993, ¶ 1. It did not bar, however, evidence of the default on the notes, which occurred in June 1990 after Germania was closed and placed in the hands of the Resolution Trust Corporation ("RTC"). The first five witnesses were investors who lost their principal in the default (Tr. 1-108), and testimony was taken about the losses of other investors. After a three-week trial in which Defendants testified, the jury rendered general verdicts of guilty on all charges.

Shortly before the district court's sentencing hearing, the court of appeals decided *United States v. Marlatt,* 24 F.3d 1005, 1007-08 (7th Cir. 1994), a mail fraud case holding that "loss" from fraud under USSG § 2F1.1 does not encompass a loss: (1) of which the defendant's acts are only a "but for" as opposed to a "legal" cause (*i.e.,* a proximate cause); or (2) that is only an "incidental and consequential" result of the defendant's acts. On the strength of *Marlatt,* Defendants persuaded the district court to admit at the sentencing hearing the evidence that had been barred at trial by the order in limine. The result was a four-day sentencing hearing on Germania's financial history from 1985 to 1990, with emphasis on "financial snapshots" of the thrift at the end of 1988 (a profitable year for Germania), the middle of 1989 (when some of FIRREA's changes were anticipated), and the end of 1989 (after FIRREA's capital rules took effect).

The Government offered little rebuttal or cross-examination, but instead argued that such evidence was irrelevant, and that its only burden was to prove the amount of note purchases. Sent. Tr. 18, 20, 526-27, 559. After hearing the evidence, the district court adopted the Government's position. The court acknowledged that "if your interpretation of *Marlatt* is correct, then the Government hasn't made any proof of what the loss was. I think they would concede that."

App. 51a. The court ruled, however, that the amount of money the note buyers paid Germania was the loss under § 2F1.1, regardless of any intervening cause. App. 52a-54a. Because that amount was more than $5 million, the court added 11 offense levels under § 2F1.1(b)(1)(L) (App. 65a).

3. The court of appeals restated the familiar sufficiency review standard of *Jackson v. Virginia*, 99 S.Ct. 2781, 2789 (1979): "[W]e construe the evidence in the light most favorable to the government and consider whether any rational jury could have found the existence of such a scheme beyond a reasonable doubt." App. 15a. The court went further, however, by holding that it was obliged to follow the jury's apparent conclusions on all factual issues.[4]

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[4] The court stated this conclusion in three contexts. (1) App. 4a: "Mindful that Morris and Gardner primarily raise a sufficiency challenge to the evidence supporting their convictions, we must resolve such conflicts in the evidence as the jury apparently resolved them — in the government's favor." (2) App. 17a: Defendants contend that the September Analysis "was never intended to reflect management's current position on necessary reserves. Yet the jury's verdict necessarily precludes us from accepting this argument." (3) App. 31a-32a, in response to Defendants' evidence of "bespeaks caution" warnings given to the note buyers (summarized at App. 29a): "The uncertain nature of predicting future loan losses does not neutralize the misleading character of [the offering circular] when the government proved to the jury's satisfaction that management's 'present analysis' (the SA) actually recommended the doubling of existing reserves." The court made similar statements at App. 18a, 19a-20a and 28a.

The Seventh Circuit has a line of cases dating back to 1970 providing a similar standard for sufficiency review:

> Only when the record contains no evidence, regardless of how it is weighed, from which the jury could find guilt beyond a reasonable doubt, may an appellate court overturn the jury.

Brandom v. United States, 431 F.2d 1391, 1400 (7th Cir. 1970), *cert. denied*, 91 S.Ct. 950 (1971). *E.g., United States v. Nesbitt*, 852 F.2d 1502, 1509 (7th Cir. 1988), *United States v. Ross*, 77 F.3d 1525, 1542 (7th Cir. 1996). Of course, *Brandom* met the "no evidence" standard set by this Court in 1960 as a

Applying this standard, the court upheld the jury verdicts against contentions that the evidence was insufficient to find a scheme or intent to defraud under the mail and wire fraud statutes. App. 15a-32a. It adopted a broad view of those statutes. App. 16a: "[T]he mail and wire fraud statutes broadly apply to any scheme 'where in order to get money . . . from someone you make a statement to him that you know to be false, or a half truth that you know to be misleading, expecting him to act upon it to your benefit and his detriment'" (quoting *Emery v. American General Finance, Inc.*, 71 F.3d 1343, 1346 (7th Cir. 1995)). See *Emery*, 71 F.3d at 1348-52 (Coffey, J., dissenting) (arguing that interpretation of mail fraud statute in that case was too broad). The court rejected Defendants' arguments that the September Analysis was not a clear, authoritative statement of Germania management's views on expected losses or reserves, and was rejected by management and the executive committee in good faith; and that the offering circular bespoke caution. It ruled that the jury's "apparent conclusions" contradicted those arguments (App. 4a, 17a-18a, 26a-28a, 31a-32a), and that securities case law did not compel the court to overrule the jury's conclusions (App. 18a-26a, 30a-31a).

On sentencing, the court of appeals held that intervening causes are irrelevant in calculating loss under § 2F1.1. App. 42a: "Even if defendants' fraud may not have caused Germania's ultimate demise, . . . the existence of intervening causes does not provide a basis for reducing the amount of loss under § 2F1.1"; App. 44a: "Even if intervening causes ultimately contributed to Germania's demise, the thing actually taken from defrauded investors was still the face

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minimum constitutional requirement in *Thompson v. Louisville*, 80 S.Ct. 624, 629 (1960). In 1979, however, the Court stated in *Jackson v. Virginia*, *supra*, 99 S.Ct. at 2789, that "the *Thompson* 'no evidence' rule is simply inadequate" as a minimum standard of sufficiency review. See *infra*, 15-16.

amount of the [notes], and that amount is thus directly charged to defendants under § 2F1.1." The court read *Marlatt* to bar "incidental or consequential" damages, but not losses with intervening causes, from § 2F1.1 calculations. App. 45a: "*Marlatt* applies, by contrast, where a victim loses not only the thing actually taken by virtue of the defendant's fraud (*i.e.*, the direct loss), but also suffers consequential or incidental damages. Although a defendant's fraud may be a 'but-for' cause of such damages, they are generally not included as loss under § 2F1.1." Under Seventh Circuit procedures, the decision in this case is now the law of the circuit with respect to losses with intervening causes under § 2F1.1.[5]

4. The court of appeals made a number of fact findings, summaries and omissions to support its holdings that it was obliged to follow the jury's apparent conclusions on all factual issues, and that a proximate cause connection between Defendants' actions and the note buyers' losses was irrelevant. Consistent with these holdings, the court treated certain factual matters as follows.

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[5] The court of appeals relied on *United States v. Miller*, 962 F.2d 739 (7th Cir. 1992), to support its ruling that intervening causes have no effect on § 2F1.1 loss calculations. The defendants in *Miller*, who made false statements to obtain HUD mortgage insurance, argued that the loss causation chain was broken because they did not default on the loans in question (the person to whom they sold the collateral property defaulted), and because HUD allegedly did a poor job of selling the property. The district court largely agreed and cut the § 2F1.1 loss from $658,000, HUD's actual loss, to the $100,000-200,000 range (see *id.* at 747, Flaum, J., concurring: "we upheld the district court's six-level increase in Miller's sentence under § 2F1.1(b)(1) for causing a loss of between $100,000-$200,000"). The court of appeals "concluded only that there was a substantial loss for which the district court properly enhanced the defendants' sentence," and noted that the Government had not appealed the loss calculation. *Id.* at 744-45. Thus, Judges Flaum's and Will's arguments, that intervening causes are irrelevant to loss calculations under § 2F1.1 but may be grounds for downward departures, were purely dicta.

a. With regard to proximate cause, the court found that in the 27 months from the end of the note sale to Germania's closure, "[t]he bank's financial condition deteriorated from [the note sale onward], and it was finally placed in conservatorship by the [RTC] in June 1990." App. 4a. The court noted "defendants' argument that they should not be allocated the entire loss because factors other than their fraud had contributed to Germania's failure." App. 37a. However, it recited none of Defendants' evidence from the sentencing hearing and made no mention of FIRREA, whose impact on Germania was the central point of that hearing and of Defendants' proximate cause argument.

Defendants' largely unrebutted evidence at the sentencing hearing supported assertions that: (1) in 1988, Germania made profits in every quarter, and at the end of that year had capital of $42 million, $19 million more than required by regulation; (2) in the first half of 1989, it reported losses largely in anticipation of accounting and capital changes to be made by FIRREA; (3) in 1987-88, thrift industry managers and professionals generally did not foresee fundamental accounting and capital changes, and much of FIRREA's substance on these issues did not become clear until July 1989, just a month before it was enacted; (4) on December 7, 1989, the day that FIRREA's capital rules took effect, Germania lost as a consequence approximately $30 million of its then roughly $40 million in capital and became capital-deficient under FIRREA's standards; (5) the largest item of capital lost that day was the notes themselves ($15.8 million), the second largest was basket reserves ($6.5 million), and the third largest was supervisory goodwill derived from the FSLIC in a 1986 acquisition of a failed St. Louis thrift ($4.5 million);[6] (6) in early 1990, the Office of Thrift Supervision ("OTS") rejected the capital

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[6] See generally *United States v. Winstar Corp.*, 116 S.Ct. __, 64 USLW 4739 (1996).

recovery plans developed by Morris and New, who then was Germania's president; (7) despite these problems, Germania's board believed the institution had the cash flow to continue meeting the required interest payments on the notes, and therefore refused to sign a proposed OTS consent order to stop those payments; and (8) the notes were therefore current when the RTC took charge of the institution and defaulted on them. Sent. Tr. 112-18, 121-24, 128-29, 132-37, 142, 304-05, 309, 311.

b. As to the purpose of the note sale, the court noted that "[t]he government's theory at trial was that the entire [note] offering had been designed by bank management to defraud potential investors." App. 16a. The court stated in the second sentence of its opinion that the notes were "subordinated capital notes" (App. 2a), but otherwise did not discuss that the purpose of the note sale was to raise capital.

The capital-raising purpose had certain implications reflected in the record, though not in the court's opinion. First, none of the note buyers' money went into Defendants' pockets. App. 59a-60a (the district court's sentencing opinion): "There is certainly no evidence in this case that these defendants profited in any way by what happened in this case. To the contrary, . . . it's clear that both of these defendants have been ruined financially, just as many of the [note] purchasers were. There is no evidence in this case that these defendants intended to profit or take the money themselves. You could argue that well, indirectly they would have, because if they got this money and if Germania succeeded, then it would be a going concern, their stock would be worth more money and so on, but there is no evidence that they intended to profit in any way"). Second, the note sale was not undertaken as a profitable venture for Germania, but as a lower cost way of raising capital than going through investment bankers. Tr. 1567 (Morris's testimony). Third, the purposes of raising capital were to foster the institution's growth and

strengthen it; it already had "adequate capital" to meet regulatory requirements. Tr. 1555 (*id.*).

c. With respect to intent, the court of appeals stated that: (1) good faith is a complete defense to mail and wire fraud; (2) the jury was instructed not to convict if it found that Defendants had made an "honest mistake" in not setting aside the $8 million basket reserve discussed in the September Analysis; and (3) "[t]he jury, however, apparently concluded that the SA's recommendations had not been rejected in good faith." App. 28a.

Trial evidence relevant to intent, not noted by the court, supported assertions that: (1) on Morris's recommendation, his son purchased a note; and during the note sale, (2) Morris invested half his 1987 bonus in Germania stock, (3) Gardner borrowed money and invested 90% of his retirement funds to buy such stock, and (4) New also bought Germania stock; and finally, (5) Germania stock was subordinate to the notes and depended for its value, as did the notes, on Germania's viability and capital adequacy. Tr. 556-58, 564-66, 1452, 1569, 1616, 1663.

d. With regard to the adequacy of Germania's loan loss reserves, the court noted that "[a]t the heart of the government's case was the [alleged mis]representation in the [note] offering that based upon its present analysis, bank management believed that it had made *adequate* provision for losses in the loan portfolio" (emphasis added). App. 16a.

New's testimony established, however, that Germania's loan loss reserves were adequate when the note sale began. New testified on cross-examination that the addition of the $1.2 million specific reserves, made "at [his] request" at the September 26, 1987, executive committee meeting, placed Germania's overall reserves in "the low range" of adequacy at that time. Tr. 637-38, 647. On direct examination, he stated that the September Analysis was prepared in order to estimate "expected" loan losses over the three-year time frame of

"Project 90." Tr. 384. New did not testify that he believed the general reserves were required to be set aside immediately; he did so testify about the specific reserves. Tr. 395-96. New did not testify on direct examination as to any time frame for taking basket reserves. Tr. 383-404. Similarly, the September Analysis itself contained no time frame for taking reserves. Gov't Ex. 24, 1-2. New testified that his agreement with Defendants at the management committee meeting of September 22, 1987, included accelerating setasides of basket reserves "to get it behind us" by 1990, but he did not testify that the agreement called for taking the basket reserves in September 1987. Tr. 383-404, 637-47. As for Defendants' role in the September 26, 1987, executive committee meeting at which the decision was made not to set aside basket reserves at that time, New described Defendants' participation as passive, stating that "[t]here would have been minor comments made but there was no real argument made by either Mr. Gardner or Mr. Morris in objection to Mr. Mason's statements." Tr. 403.

e. On Germania's sales practices, the court noted that "substantial evidence at trial addressed" whether Germania used "misleading" and "high pressure tactics to convince risk-averse, unsophisticated depositors to purchase [notes]." The court said it was unnecessary to reach or further discuss the issue. App. 32a n. 12.

The record also indicates that the district court denied a Government request for an upward departure for targeting vulnerable victims; citing trial and sentencing evidence, it found "that there was no intent to target some vulnerable group." App. 55a. Several investor witnesses testified that Germania's sales pitches were low-pressure, Tr. 14-16, 64, 69-73, and that no claims were made that the notes had deposit insurance, Tr. 53, 70-71, 78-79, 99.

f. The court of appeals portrayed the trial as a credibility contest. App. 4a text and n. 3; App. 18a ("[i]n convicting defendants on all charges, the jury obviously believed

New, not Morris and Gardner"). Under *Jackson v. Virginia,* that would place the verdict largely beyond sufficiency review (99 S.Ct. at 2789: appellate courts must give "full play to the responsibility of the trier of fact fairly to resolve conflicts in the testimony [and] to weigh the evidence").

However, as noted *supra,* 10-11, with respect to New's testimony on the adequacy and timing of Germania's reserves, substantial portions of his testimony were exculpatory for Defendants. In a week on the stand recorded in nearly 400 pages of transcript, New testified on many events at Germania. He did not significantly contradict his own testimony at the trial. The court's adherence to the jury's apparent conclusions was effectively, in *Jackson*'s terms, a ruling that it was rational for the jury to ignore the parts of New's testimony inconsistent with the verdict. It was also a decision by the court to itself ignore such testimony. There was no credibility contest within New's testimony.

Furthermore, all the record evidence cited in this petition, both government and defense evidence, is unrebutted or nearly so with two exceptions: New's assertion that he made an agreement with Defendants at the management meeting on September 22, 1987, to adopt the loss expectations in the September Analysis; and his description of how the decision was made at the executive committee meeting on September 26, 1987, not to set aside $8.1 million of general reserves at that time. There can be no credibility contest over unrebutted evidence. Rather, the credibility issue becomes one of whether the jury and reviewing court will give any credence or weight to such evidence. *Cf. Jackson,* 99 S.Ct. at 2790: "[C]ourts can and regularly do gauge the sufficiency of the evidence without intruding into any legitimate domain of the trier of fact."[7]

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[7] See *United States v. Baker,* 61 F.3d 317, 322 (5th Cir. 1995) (court's reviewing role is greater where the case presents "not so mush a case of credibility determinations . . . as a mixture of fact and law: whether the actions

g. As to the evidence actually weighed by the court in evaluating sufficiency, it is of course inappropriate and infeasible to speculate on the court's thought processes or the breadth of its review of the record. The court stated that "[t]he evidence we have detailed amply supports these conclusions" that the September Analysis was rejected in bad faith and that the offering circular was fraudulent. App. 28a.

In light of this statement, it is notable that in the court's entire opinion, apart from a half dozen summaries of Defendants' factual contentions (*e.g.*, App. 17a, 20a, 26a-27a), only five specific items of exculpatory evidence were "detailed" or recited.[8] Having declined to "detail" or recite the crux of Defendants' case, and having recited only evidence consistent with the jury's verdict (with those five minor exceptions), the court left open the question whether it obeyed *Jackson's* mandate to review "*all of the evidence*" (99 S.Ct. at 2789 (emphasis in original)).

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and choices of defendants . . . were proscribed by criminal statutes"); *United States v. Beuttenmuller*, 29 F.3d 973, 980 text and n. 17 (5th Cir. 1994) (reasonable fact-finder could not find beyond a reasonable doubt that unrebutted evidence was entitled to no weight or credence, and may not use mere speculation to reject such evidence; crediting defendants' unrebutted evidence and reversing conviction; see *infra*, 17).

[8] The five items, none fundamental to Defendants' case, were: (1) Morris postponed a stock sale in 1986 to allow time to take larger loan loss provisions (App. 5a); (2) Germania substantially upgraded its commercial loan review process in the year before the note sale (App. 5a-7a); (3) Germania's outside auditors declined to examine the September Analysis when New offered it to them at year-end 1987 (App. 12a n. 7); (4) the "bespeaks caution" evidence recited at App. 29a; and (5) the IRS challenged Germania in 1989 for allegedly excessive loan loss reserves during the period of the note sale (App. 34a n. 14).

REASONS FOR GRANTING THE PETITION

A. The Court of Appeals' Standard of Review Nullifies the Standard Set Forth in *Jackson v. Virginia*.

1. *Jackson* recognized that juries sometimes return "unreasonable verdict[s]" of guilty or not guilty. 99 S.Ct. at 2788, text and n. 10. Although "convictions are [in]frequently reversed upon [sufficiency] ground[s], . . . the application of the beyond-a-reasonable-doubt standard is not irretrievably committed to jury discretion." *Id.* To assure defendants the benefit of "so fundamental a substantive constitutional standard," there must be judicial review that "require[s] that the factfinder will rationally apply that standard to the facts in evidence. . . . [Sufficiency review must] determine whether the record evidence could reasonably support a finding of guilt beyond a reasonable doubt." *Id.*, 2788-89.

To achieve that objective, the Court set out a standard and process for sufficiency review involving two steps: first, to *consider* all the evidence in the light most favorable to the prosecution, and then, to *resolve* factual issues in the prosecution's favor if, but only if, the reviewing court determines that based on the evidence so viewed a rational jury could have found each element of the crime to be established beyond a reasonable doubt. *Id.*, 2789. See also *Glasser v. United States*, 62 S.Ct. 457, 469 (1942).

Despite citing *Jackson*, the court of appeals left no room for sufficiency review on *Jackson*'s terms. The court's standard of accepting the jury's apparent conclusions on all factual issues is incompatible with *Jackson*. Simply put, if a reviewing court must accept the jury's conclusions about the evidence, then it is impossible to ask, let alone determine, whether any rational jury could have reached those conclusions. If a court must accept the jury's conclusions, then there is no point in reviewing any of the evidence, for sufficiency or any other purpose. Under the

court of appeals' standard, a reviewing court cannot apply a rational factfinder test because the jury is deemed correct whether it was rational or not. The beyond-a-reasonable-doubt standard is irrelevant, as is exculpatory evidence.

Under a similar standard more commonly cited by the court of appeals — reversal only if there is no evidence of guilt beyond a reasonable doubt, first stated in *Brandom v. United States,* 431 F.2d 1391, 1400 (7th Cir. 1970) (*supra,* 5 n. 4) — the contrast with *Jackson* is only slightly less stark. Under *Brandom,* the question is whether any evidence supports the verdict, while under *Jackson,* the question is whether all the evidence, seen in the light most favorable to the prosecution, can rationally support the verdict. Thus, *Brandom* involves neither a test of all the evidence against the beyond-a-reasonable-doubt standard, nor a rational factfinder test. Exculpatory evidence is also irrelevant under *Brandom.*

Consequently, under the standard of review used by the court of appeals in this case, as well as under the *Brandom* "no evidence" standard, proper sufficiency review is *de jure* nearly impossible in the Seventh Circuit. In the 26 years since *Brandom,* the court of appeals has reversed but a handful of convictions on sufficiency grounds. Two such cases are *United*

States v. Rahman, 34 F.3d 1331 (7th Cir. 1994),[9] and *United States v. Brooks*, 748 F.2d 1199 (7th Cir. 1984).

2. In contrast to the Seventh Circuit, the District of Columbia, Second, Third, Fourth, Fifth, Eighth and Ninth Circuits have devised rules and procedures to implement the *Jackson* standard.

First, the District of Columbia and Second Circuits have held that they were required to judge the evidence independently, rather than accept the jury's apparent conclusions. *United States v. Singleton*, 702 F.2d 1182, 1183 (D.C. Cir. 1983) (per curiam) (en banc) (on review of district court's granting of a post-verdict motion of acquittal: "we do not defer to the district court, because we must make our own independent judgment regarding the sufficiency of evidence. . . . [U]ltimately, the decision whether or not the evidence was sufficient is a question of law and therefore entirely our own"); *United States v. Long*, 905 F.2d 1572, 1576 (D.C. Cir.) (after stating the *Jackson* standard: "We do not, however, fulfill our

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[9] In *United States v. Rahman*, the court recognized the contradiction between the no-evidence and *Jackson* standards, noted that *Jackson* superseded the no-evidence standard, and adopted a unique standard compromising the two, though closer to *Jackson*'s. Compare *Rahman*, 34 F.3d at 1337 ("the defendant [must] demonstrate that . . . the evidence cannot support a finding of guilt beyond a reasonable doubt"), with *Jackson*, 99 S.Ct. at 2789 (the reviewing court must determine that "*any* rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt" (emphasis in original)).

In this case, the Government advocated the *Brandom* no-evidence standard of review. Defendants countered with the standard stated in *Rahman*. Pet.C.A.Rep.Br. 1. The court adopted a standard — that it was required to accept the jury's apparent conclusions on all factual issues -- even more adverse to proper sufficiency review than *Brandom*'s.

Under Seventh Circuit procedures, the standard in this case, and the no-evidence standard restated in *United States v. Ross*, *supra*, 5 n. 4, comprise the law of the circuit because they are more recent than *Rahman*. Notably, Judge Kanne served as a member of the panel in all three cases.

duty through rote incantation of these principles followed by summary affirmance. We must ensure that the evidence adduced at trial is sufficient to support a verdict as a matter of law. A jury is entitled to draw a vast range of reasonable inferences from evidence, but may not base a verdict on mere speculation"), *cert. denied,* 111 S.Ct. 365 (1990); *United States v. Martinez,* 54 F.3d 1040, 1043 (2d Cir. 1995) ("where a fact to be proved is also an element of the offense . . . it is not enough that the inferences in the government's favor are permissible. We must also be satisfied that the inferences are sufficiently supported to permit a rational juror to find that the element, like all elements, is established beyond a reasonable doubt").

Second, the Fifth Circuit has held that unrebutted evidence cannot be discounted without a rational reason. In *United States v. Beuttenmuller, supra,* the Government contended that the property in question had no equity, but the sole evidence of the property's value, an appraisal introduced by the defense, set a $4 million value which implied an equity value of $1.8 million. *Id.,* 29 F.3d at 980. The Fifth Circuit held the jury could not speculate that the property had no equity or that a sale of the property was a sham, and therefore reversed the conviction. *Id.,* 980-81. "Although there was some question concerning the appraised value at trial, no evidence was introduced that could reasonably lead a jury to conclude that the appraisal was so flawed or otherwise invalid that the jury could ignore it altogether. . . . [N]o juror could conclude beyond a reasonable doubt that the transaction in question was a [sham]." *Id.,* n. 17.

Third, the Second, Fifth and Ninth Circuits have ruled that if "the evidence viewed in the light most favorable to the prosecution gives equal or nearly equal circumstantial support to a theory of guilt and a theory of innocence, the conviction should be reversed." *United States v. Schuchmann,* 84 F.3d 752, 754 (5th Cir. 1996) (citation and quotation omitted); *United*

States v. D'Amato, 39 F.3d 1249, 1256 (2d Cir. 1994); *United States v. Penagos,* 823 F.2d 346, 349-50 (9th Cir. 1987).

Fourth, in fraud cases the Second, Fifth and Eighth Circuits have undertaken the laborious task of "examin[ing in detail] the underlying transaction and determin[ing] whether there was sufficient evidence to allow a jury to conclude beyond a reasonable doubt that" the transaction in question was illegal or that the elements of fraud were established. *United States v. Baker, supra,* 61 F.3d at 325; *United States v. D'Amato, supra,* 39 F.3d at 1259-62; *United States v. Starr,* 816 F.2d 94, 99 (2d Cir. 1987) (*e.g.,* reviewing direct and cross-examination of government witness); *United States v. McNeive,* 536 F.2d 1245, 1246 (8th Cir. 1976) ("plenary consideration of the relevant facts in this case is necessary for a full understanding of the appeal"). Similarly, the Fifth Circuit has patiently sifted through prosecution and defense evidence and the inferences that could be drawn therefrom in the light most favorable to the prosecution, to determine whether the evidence could persuade a rational factfinder beyond a reasonable doubt of the defendant's guilt. *United States v. Schuchmann, supra,* 84 F.3d at 754-58. Finally, the Second and Fifth Circuits have held that if a transaction was legal and conferred "value-for-value" on the parties, a scheme or intent to defraud "cannot be inferred from the circumstances surrounding the transaction." *United States v. Beuttenmuller, supra,* 29 F.3d at 981; *United States v. Baker, supra,* 61 F.3d at 324-25; *United States v. Starr, supra,* 816 F.2d at 99 ("[a]lthough all *reasonable* inferences must be drawn in favor of the government on this appeal, we are convinced that the jury must have resorted to rank speculation in finding fraudulent intent here" (emphasis in original)).

Fifth, none of these courts attempts to divine the jury's "apparent" or "obvious" conclusions, as the Seventh Circuit did repeatedly in this case (App. 4a, 18a, 28a). Instead, these courts took their own look at all the evidence, and then stated what the evidence showed when viewed in the light most

favorable to the prosecution. *E.g., United States v. D'Amato, supra,* 39 F.3d at 1252 (introducing the evidence by stating that "[i]n light of [the *Jackson*] standard, a rational juror could have found the following from the evidence presented at trial"). *Jackson,* 99 S.Ct. at 2789 n. 13, stated that it is inappropriate to guess the jury's actual thought processes. In this case (as in any other), the court of appeals had no assurance — unless it conducted its own rational review of all the evidence — that the jury came to any conclusions at all except the verdict, or considered the evidence in a reasonable manner.

Sixth, in cases involving the mailing element of mail fraud, the Third, Fourth and Fifth Circuits have held that the beyond-a-reasonable-doubt standard requires proof of more than a probability of an element of crime. *United States v. Burks,* 867 F.2d 795, 797 (3d Cir. 1989) (mail fraud conviction reversed despite high probability that mails were used); *United States v. Massey,* 827 F.2d 995, 999 (5th Cir. 1987) (same); *United States v. Scott,* 730 F.2d 143, 147 (4th Cir.) (same), *cert. denied sub nom, Wilson v. United States,* 105 S.Ct. 572 (1984). This Court has "emphasized that proof beyond a reasonable doubt has traditionally been regarded as the decisive difference between criminal culpability and civil liability. . . . [Such proof must enable the rational factfinder] to reach a subjective state of near certitude of the guilt of the accused." *Jackson,* 99 S.Ct. at 2787. See also *Victor v. Nebraska,* 114 S.Ct. 1239, 1247 (1994) (such proof must establish a "very high level of probability").

Seventh, the Fifth Circuit has focused on the quantum of evidence of guilt by holding that reversal is required "when the evidence, viewed in the light most favorable to the government, is so scant that the jury could only speculate as to defendant's guilt." *United States v. Herberman,* 583 F.2d 222, 231 (5th Cir. 1978). Similarly, *Jackson* stated that a "'modicum' of evidence could [not] by itself rationally support a conviction beyond a reasonable doubt." 99 S.Ct. at 2789.

Because much of the evidence in this case was not subject to a credibility contest, and because the Seventh Circuit left open the question whether it considered all the evidence, *supra,* 11-13, the seven rules and procedures cited above could have assisted in the review of this case. However, the Seventh Circuit used none of these rules and procedures in this case, and has recognized none of them in its case law. In any event, under the standard of review the Seventh Circuit adopted here, none of them could have affected the outcome.

3. *Jackson*'s statements about sufficiency review on direct appeal were, of course, dicta because *Jackson* was a habeas case. This Court has never addressed such review on a direct appeal, although the Court and several Justices have stated that the *Jackson* standard does apply on direct appeal. *E.g., Tibbs v. Florida,* 102 S.Ct. 2211, 2220, 2222 (1982) (the Court) (White, J., dissenting); *Albright v. Oliver,* 114 S.Ct. 807, 827 (1994) (STEVENS, J., dissenting).

The Court has, of course, applied or addressed the *Jackson* standard in a wide variety of other contexts. *E.g.,* jury instructions on the beyond-a-reasonable-doubt standard (*Victor v. Nebraska, supra,* 114 S.Ct. at 1247); standards of habeas review of "aggravating circumstances" in support of death penalty (*Lewis v. Jeffers,* 110 S.Ct. 3092, 3102-04 (1990)); and standards of habeas review of trial evidence and new evidence (*Wright v. West,* 112 S.Ct. 2482 (1992), and *Herrera v. Collins,* 113 S.Ct. 853, 861 (1993)).

4. Review of this case by the Court would have great practical value. The standard of sufficiency review is the threshold issue not only in sufficiency appeals but also in thousands of motions for judgments of acquittal filed every year in the district courts. As noted above, the Court has never addressed this standard on a direct appeal — the setting needed to flesh out the details and resolve the conflicts among the circuits.

Review of this case would be timely in light of the habeas provisions of the Anti-Terrorism and Effective Death Penalty Act of 1996. As habeas litigation becomes more narrowly focused, more emphasis will fall on direct appeals. A full, updated analysis of sufficiency review principles by the Court is essential.

Standards of appellate review are crucial to our system of justice. *E.g., Ornelas v. United States,* 116 S.Ct. 1657 (1996). There is no standard more important than that governing sufficiency review in criminal cases.

B. As the Court Has Made Clear in Other Contexts, the Applicable Causation Concept under the Mail and Wire Fraud Statutes, Connecting the Defendants' Acts and the Actual or Potential Harm to the Targets of Fraud, Is Proximate Cause.

1. The Court has indicated twice in the last five years that the near-universal principle of proximate cause applies whenever causation must be determined under federal law, absent a contrary statute.

In *Holmes v. Securities Investor Protection Corp.,* 112 S.Ct. 1311, 1316-18 (1992) ("*SIPC*"), the Court explained that under the RICO statute, as well as under the antitrust laws and in American tort law in general, the courts have created the proximate cause doctrine in response to "a demand for some direct relation between the injury asserted and the injurious conduct alleged." The Court held that individuals who allegedly manipulated certain securities in dealings with a failed broker-dealer could not be held liable to SIPC for its costs in making good losses suffered by the broker-dealer's customers who did not invest in the manipulated securities; the proximate cause chain was broken by the broker-dealer's failure. *Id.,* 1319-21. Justice Scalia, concurring in the judgment, said that "a proximate-cause requirement . . . is a background practice against which Congress legislates." *Id.,* 1328. "One of the usual

elements of statutory standing is proximate causality. . . . [I]t has always been the practice of common-law courts . . . to require as a condition of recovery, unless the legislature specifically prescribes otherwise, that the injury have been proximately caused by the offending conduct." *Id.*, 1327. Justice Scalia noted that the necessary proximate cause showings would vary under different RICO predicate criminal statutes. *Id.*, 1328. *SIPC* was predicated on allegations of securities, mail and wire fraud. *Id.*, 1315.

In *United States v. Aguilar,* 115 S.Ct. 2357 (1995), the Court applied the proximate cause concept to an obstruction of justice statute, 18 U.S.C. § 1503. The Court approved circuit rulings that there is "a 'nexus' requirement — that the act must have a relationship in time, causation or logic with the judicial proceedings. . . . In other words, the [obstructive] endeavor [whether successful or not] must have the 'natural and probable effect' of interfering with the due administration of justice." *Id.*, 2362. Justice Scalia in dissent urged a different proximate cause concept with a broader reach. *Id.*, 2367-69. Under both opinions, the proximate cause concept was used to determine whether the defendant had the requisite specific intent.

As noted in *SIPC,* proof that defendants' actions proximately caused actual anticompetitive harm in a relevant market is required in civil antitrust actions. *Associated General Contractors of California, Inc. v. Carpenters Council,* 103 S.Ct. 897, 903-11 (1983). The same is true in criminal antitrust actions. While the Court in *United States v. United States Gypsum Co.,* 98 S.Ct. 2864, 2877 (1978), focused on the intent requirement in such actions, it held "that action [by defendants] undertaken with knowledge of its probable consequences and *having the requisite anticompetitive effects* can be a sufficient predicate for a finding of criminal liability under the antitrust laws" (emphasis added). See also *id.*, 98 S.Ct. at 2788 n. 22.

The historical basis in the case law of the late nineteenth century for requiring proof of proximate cause under

the antitrust statutes (see *Associated General Contractors, supra,* 103 S.Ct. at 907 n. 33) also applies to the mail fraud statute, originally enacted in 1872. See *McNally v. United States,* 107 S.Ct. 2875, 2879-80 (1987), for the early history of that statute.

2. The mail and wire fraud statutes raise the issue of causation in their key phrases: "having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1341, 1343 (App. 62a). The phrase "to defraud, or for obtaining money or property" connotes a causal connection between the alleged fraudulent conduct and the actual or potential harm to victims.[10]

Although the Court has interpreted the mail and wire fraud statutes many times, *e.g., McNally* and *Carpenter v. United States,* 108 S.Ct. 316 (1987), the Court has never addressed, as its primary focus in a case under these statutes, the parameters of the required causal connection between the alleged fraudulent conduct and the actual or potential loss to the victims. *Carpenter,* however, was in effect a ruling that Winans's actions proximately caused harm to the property interests of the *Wall Street Journal* (108 S.Ct. at 320-22).

3. In a trio of cases, *United States v. D'Amato, supra, United States v. Starr, supra,* and *United States v. Regent Office Supply Co.,* 421 F.2d 1174 (2d Cir. 1970), the Second Circuit has required a showing of proximate cause as part of the proof of criminal intent of mail and wire fraud.

Focusing on the actual or potential injury to the victim, the court in *Regent Office Supply* held:

> Although proof that the injury was accomplished is not required to convict under [§] 1341, we believe the statute does require evidence from

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[10] Potential harm is included because a scheme to defraud need not be successful or complete to be actionable. *Durland v. United States,* 16 S.Ct. 508, 512 (1896).

> which it may be inferred that some actual injury to the victim, however slight, is a reasonably probable result of the deceitful representations if they are successful.

Regent Office Supply, 421 F.2d at 1182. The Seventh Circuit expressed doubt about the *Regent Office Supply* holding in *United States v. Castor,* 558 F.2d 379, 383 (1977), *cert. denied,* 98 S.Ct. 720 (1978). On the other hand, Judge Garwood of the Fifth Circuit endorsed that holding in *United States v. Curry,* 681 F.2d 406, 420-21 (5th Cir. 1982) (Garwood, J., concurring).

In *Starr,* the court distinguished between "deceit" and fraud, the latter being deceit tied to an actual or potential harm to the victim contemplated by the defendant.

> Misrepresentations amounting only to a deceit are insufficient to maintain a mail or wire fraud prosecution. Instead, the deceit must be coupled with a contemplated harm to the victim. Moreover, the harm contemplated must affect the very nature of the bargain [between the defendant and victim] itself. . . . [A benefit to the defendant] cannot be probative of fraudulent intent unless it results, or is contemplated to result, from a corresponding loss or injury to the victim of the fraud.

Starr, 816 F.2d at 98, 101.

D'Amato, 39 F.3d at 1257, stated that the reviewing court must determine whether "the 'necessary result' of the actor's scheme is to injure others." If so, "fraudulent intent may be inferred from the scheme itself"; if not, "the government must produce evidence independent of the alleged scheme to show the defendant's fraudulent intent." *Id.*

In contrast to the Second Circuit's careful causation analysis, the Seventh Circuit in this case tacitly assumed that Defendants caused the note buyers' losses. In the terms of *Regent Office Supply,* the Seventh Circuit did not require or

recite evidence that a default on the notes was "a reasonably probable result" of the decision not to set aside new basket reserves before the note sale. In *Starr*'s terms, the Seventh Circuit simply assumed that Defendants' alleged "deceit" was also actionable "fraud." In *D'Amato*'s terms, although a default was not a "necessary result" of the note sale, the Seventh Circuit did not require or recite evidence of intent "independent of the alleged scheme."

4. The Court should resolve the vastly different approaches of the Second and Seventh Circuits on proximate cause under the mail and wire fraud statutes. Favoring the Second Circuit are the language of the statutes, their common law background, and the rule of lenity recognized many times by the Court (*e.g., McNally, supra,* 107 S.Ct. at 2881-82).

In ruling on proximate cause, the Court should continue the course set in *SIPC* and applied to obstruction of justice and antitrust in *Aguilar* and *United States Gypsum.* The Court may wish to make a general statement about the need for and parameters of proving proximate cause in federal criminal cases.

In this regard, it is emphasized that the evidence referenced in the Statement of the Case, Parts 4.a-c (*supra,* 7-10), indicates that the record in this case will permit the Court to rule meaningfully on the extent of causal connection that must be established under the mail and wire fraud statutes between perpetrators' alleged fraudulent conduct and victims' actual or potential loss.

C. For Similar Reasons, the Applicable Causation Concept under the Sentencing Guidelines, Connecting the Defendants' Acts and the Actual or Potential Loss from Fraud, Is Proximate Cause.

1. The principles of *SIPC, Aguilar,* and *United States Gypsum* clearly apply to the calculation of loss from fraud under USSG § 2F1.1. The Sentencing Commission's enabling statute directs the Commission to "consider . . . the nature and degree of the harm caused by the offense." 28 U.S.C. § 994(c)(3) (App. 63a). An introductory guideline on "Relevant Conduct" states that "injuries relevant to the offense of conviction shall be taken into account" by the district courts in rendering sentences, and that "[i]njury relevant to the offense of conviction means harm which is caused intentionally, recklessly or by criminal negligence in the course of conduct relevant to the offense of conviction." USSG § 1B1.3 (App. 64a). See *United States v. Neadle,* 72 F.3d 1104, 1114-15 (3d Cir. 1995) (Becker, J., dissenting) (discussing effect of § 1B1.3 on loss calculation under § 2F1.1). Section § 2F1.1(b)(1) (in the November 1987 version applicable to this case) bases offense level increases on the "estimated, probable or intended loss." The commentary, in Application Note 8 and the background statement, addresses the loss caused to victims. App. 64a-65a.

2. The First, Third and Ninth Circuits have ruled, like the court of appeals, that intervening causes are irrelevant to loss calculation under § 2F1.1. *United States v. Neadle, supra,* 72 F.3d at 1110: "[I]t is not appropriate to reduce the amount of the loss, as computed under the Guidelines, in order to reflect other causes of the loss which were beyond the defendant's control"; *United States v. Shattuck,* 961 F.2d 1012, 1016-17 (1st Cir. 1992) ("Any portion of the total loss sustained by the victim as a consequence of factors extraneous to the defendant's criminal conduct is *not* deducted from total 'victim

loss' . . . [under] § 2F1.1(b)(1)"; emphasis in original); *United States v. Sarno*, 73 F.3d 1470, 1500-01 (9th Cir. 1995) (citing *Shattuck*).

Opposing this view, the Tenth Circuit in *United States v. Smith*, 951 F.2d 1164 (10th Cir. 1991), used a proximate cause rationale to reduce a loss of $441,000, as found by the district court, to zero. The defendant home builder made false statements concerning home buyers' downpayments on six federally insured loans. The district court set the § 2F1.1 loss at the amount of the loans. Reversing, the Tenth Circuit found: "Although Mr. Smith did receive all the proceeds from the loans, he delivered to the lenders something in return: the security interest in the houses and the promises of the individual borrowers to repay the loans. . . . Mr. Smith's misrepresentations resulted in an exchange for value, not a net loss to the lending institutions." *Id.*, 1167-68.[11] Similarly, the Tenth Circuit held that no "intended" or "probable" loss was shown, indicating that it had been the Government's burden to establish that, at the time of the misrepresentations, a loss to the lenders or the Government was either intended or probable. *Id.*, 1168-69. The court further indicated that the district court should have given weight to Smith's unrebutted testimony that he intended no loss, because there was no testimony to the contrary and because of the good-paying performance of the loans for several years after the misrepresentations. *Id.*

The Fourth Circuit also used a proximate cause rationale in *United States v. Baum*, 974 F.2d 496 (4th Cir. 1992). The defendants, a married couple, refinanced their home

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[11] This finding patently contradicts the court of appeals' finding in this case that the receipt by Germania of the note buyers' money was money "taken" under the Sentencing Guidelines. App. 44a. In return for their money, the note buyers received notes from a properly capitalized, then-prospering bank, notes that paid interest as contracted until after the RTC took over Germania.

mortgage by submitting a fraudulent loan application after the husband's illness caused a loss of income. As in *United States v. Smith, supra,* the district court valued the § 2F1.1 loss at the amount of the loan. *Id.,* 498. The Fourth Circuit reversed, holding that "the potential consequences of default [at the time the loan was made], rather than the amount of the loan, best measure the 'loss' to which [the defendants] exposed the lender." *Id.,* 499. The court ordered that on resentencing the defendants receive a deduction for the value of the security the lender received, and "consider[ation]" for the several years of payments they made on the loan. The court found that the defendants "intended to fully pay off the loan." *Id.*

In his dissent in *United States v. Neadle, supra,* 72 F.3d at 1112-23, Judge Becker contended that USSG §§ 1B1.3 and 2F1.1 require proof of at least "but for" cause before charging a fraud defendant with loss, and argued that the facts in that case did not support a finding of "but for" cause in the amount determined by the district court and affirmed by the Third Circuit's majority. "It may ultimately be appropriate to hold that only harm proximately caused by the defendant's conduct can be deemed 'loss.'" *Id.,* 1120 n. 10 (citing *United States v. Marlatt, supra*). "Sentencing defendants on the basis of fortuitous harm that they in no sense caused would thwart" the fairness and uniformity policies of the Guidelines. *Id.,* 1119.

3. As on the issue of proximate cause under the mail and wire fraud statutes, the evidence referenced in the Statement of the Case, Parts 4.a-c (*supra,* 7-10), indicates that the record in this case will permit the Court to rule meaningfully on whether, and to what extent, a proximate cause determination must be made in calculating loss under § 2F1.1.

Defendants contended in the court of appeals that the Government's loss calculations failed the crucible of proximate cause when tested in separate two time frames: (1) through 1988, when the note sale was completed and added to Germania's capital, the note holders had no loss, and the

institution was profitable and well capitalized under then-governing rules; and (2) through June 1990, when Germania became capital-deficient under FIRREA's rules, and the RTC defaulted on the notes following the OTS decision to close the institution. Pet.C.A.Rep.Br. 23-24.

4. This Court has never addressed the frequently litigated issue of loss calculation under § 2F1.1. The wide circuit conflict on this issue is likely to grow until the Court intercedes. The Court's views on the general applicability of the proximate cause doctrine, set forth in *SIPC* and applied in *Aguilar* and *United States Gypsum*, should also apply to sentencing under the Guidelines.

CONCLUSION

The petition for a writ of certiorari should be granted.

July 1996

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 94-2740, 94-2741

UNITED STATES OF AMERICA,
PLAINTIFF-APPELLEE

V.

EDWARD L. MORRIS AND STEVEN M. GARDNER,
DEFENDANTS-APPELLANTS

On Appeal from the United States District Court
for the Southern District of Illinois
(No. 92 CR 30144)

Before: CUMMINGS, KANNE, and ROVNER,
Circuit Judges.

(June 2, 1995, Argued; April 2, 1996, Decided)

OPINION OF THE COURT

ROVNER, Circuit Judge. The defendants in this mail and wire fraud prosecution are former officers of Germania Bank, a St. Louis-based savings and loan association. After a lengthy trial, a jury convicted the bank's former chief executive officer, Edward L. Morris, and its former chief operating officer, Steven M. Gardner, on two counts of mail (18 U.S.C. § 1341) and one count of wire fraud (18 U.S.C. § 1343) in connection with Germania's $10 million offering of subordinated capital notes ("Schnotes") between October 1987 and March 1988.[1] The district court sentenced Morris and Gardner to prison terms of forty-six months, but stayed those sentences during the pendency of their appeals. In challenging their convictions, Morris and Gardner argue that the government's evidence at trial was insufficient to establish violations of the mail and wire fraud statutes and, alternatively, that they are entitled to new trials due to the government's failure to produce exculpatory evidence under *Brady v. Maryland*, 373 U.S. 83, 10 L. Ed. 2d 215, 83 S. Ct. 1194 (1963). Defendants also challenge the sentences they received under the Sentencing Guidelines, contending that the district court erred in calculating the amount of loss attributable to their fraud under U.S.S.G. § 2F1.1(b)(1), and in refusing to depart downward from their sentencing range to account for other alleged causes of that loss. For the reasons that follow, we affirm defendants' convictions and sentences.

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[1] Morris and Gardner also face charges stemming from the Schnote offering in the Eastern District of Missouri, as the offering occurred both in that district and in the Southern District of Illinois. After they were convicted below, Morris and Gardner moved to dismiss the Missouri prosecution on double jeopardy grounds. The district court denied that motion, and the Eighth Circuit affirmed. *See United States v. Gardner*, 65 F.3d 82 (8th Cir. 1995), cert. denied, 133 L. Ed. 2d 696, 116 S. Ct. 748 (1996).

I.

Prior to the deregulation of the savings and loan industry in the early 1980s, Germania had primarily been involved in residential real estate loans. After deregulation, however, the bank expanded its loan portfolio, involving itself in larger multi-family residential and commercial projects. This case involves problems that developed in the bank's loan portfolio in 1986 and 1987, and particularly the bank's decisions in taking and in failing to take loss reserves on that portfolio.[2] The crux of the government's case is that the Executive Committee of Germania's Board of Directors failed to approve an additional $9.3 million in loan loss reserves recommended by bank management in September 1987 pursuant to an in-depth quarterly review of the bank's loan portfolio (the "September Analysis" or "SA"). The government maintained that the recommended reserves were rejected not because the Executive Committee decided they were unnecessary, but because Germania was about to embark on the $10 million Schnote offering and its controlling shareholder insisted that the bank show a profit for the quarter ending September 30, 1987. Because the reserves recommended by management would have caused a significant third-quarter loss, the Executive Committee authorized only those reserves necessary to cover identified losses in the portfolio, with gradual increases to follow over time. Germania then proceeded with the Schnote offering, using an offering circular that described current loan loss

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[2] A "loan loss reserve" is a "statement of condition, or balance sheet, account set up by a bank based on its expectations about future loan losses. As losses occur, they are charged against this reserve. That is, the loan account is credited and the reserve account is debited. The reserve is established by a debit to an expense account called the loan loss provision, with a corresponding credit to the loan loss reserve." *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 281 (3d Cir.) (quoting American Bankers Association, *Banking Terminology* 215 (1989)), *cert. denied*, 506 U.S. 934, 121 L. Ed. 2d 278, 113 S. Ct. 365 (1992).

reserves as "adequate." It is management's dissemination of this offering circular to potential investors that is at the heart of the government's mail and wire fraud charges.

Almost five months after the Schnote offering began, Peat, Marwick, Main & Co. ("Peat Marwick"), in connection with its year-end audit of Germania's financial statements, recommended loan loss reserves of a magnitude similar to those recommended by management in the September Analysis. Germania eventually took an additional $9.4 million in reserves in February 1988, near the conclusion of the Schnote offering. The bank's financial condition deteriorated from that point, and it was finally placed in conservatorship by the Resolution Trust Corporation (the "RTC") in June 1990. With Germania's demise, the Schnotes became worthless, and investors recouped nothing on their investments.

The evidence presented through a multitude of witnesses to the jury in this case was replete with contradictions.[3] The most numerous and significant concerned the nature and purpose of the SA, as well as the substance of the Executive Committee's discussion of its recommendations. Mindful that Morris and Gardner primarily raise a sufficiency challenge to the evidence supporting their convictions, we must resolve such conflicts in the evidence as the jury apparently resolved them--in the government's favor. We thus describe in somewhat abbreviated form below the evidence presented at trial as construed in the light most favorable to the government. *See United States v. Biesiadecki*, 933 F.2d 539, 545 (7th Cir. 1991).

A.

The government's case depended heavily upon the testimony of Jimmy Wayne New, a former bank officer who

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[3] Indeed, the factual statements in the parties' briefs to this court recite starkly different versions of the evidence presented to the jury.

pled guilty to his role in the Schnote offering and agreed to cooperate with the government. New served as the bank's chief financial officer during the relevant time period and was a member of its Executive Committee. New was therefore present, along with Morris and Gardner, at the central meeting that concerns us here. Before discussing that meeting, however, we describe the events preceding it that apparently prompted management's decision to compile the in-depth analysis of the bank's loan portfolio that came to be known as the September Analysis.

Approximately one year before the Schnote offering, Germania conducted a public offering of its stock. Before the offering began, however, Morris became concerned about the bank's loan portfolio and the adequacy of its allowance for loan losses. Morris therefore decided to postpone the stock offering to allow for further investigation. New was on vacation in Mexico at the time, and Morris called him there to tell him that the offering would be postponed. Morris explained that in the course of inspecting certain properties that were the subject of Germania loans, he had become concerned about the level of the bank's reserves. Morris wanted a complete analysis of the bank's loan portfolio compiled before he would proceed with the public stock offering. When New returned from his vacation, he oversaw an in-depth inspection of a large segment of the bank's loan portfolio. As a result of that investigation, Germania took additional reserves, disclosed those reserves in the offering circular, and then proceeded with the stock offering. The 1986 stock offering eventually raised in excess of $5 million, but the per share price was lower than Germania had expected prior to taking the additional reserves.

In February 1987, the bank's auditors issued their report on Germania's financial statements for the year ending December 31, 1986. In connection with that report, Peat Marwick sent a "management letter" to Germania's Board of

Directors expressing concern about the bank's control over its loan portfolio:

> During our review of large loans, we noted no documentation evidencing ongoing monitoring of several large commercial loans. As noted in our prior year management letter, this practice exposes the Association to the risk that it may not become aware of declines in collateral value or other problems until a loan becomes delinquent. Subsequent to year-end, the Association has implemented a system to review selected large loans on an annual basis. We recommend strict adherence to this policy. In addition, we recommend that non-real estate commercial loans be reviewed on at least a quarterly basis, and that current financial data be obtained and reviewed in connection with this ongoing review. For both types of commercial loans, we recommend that loan files contain documentation of the ongoing review and monitoring procedures performed, including the conclusions as to whether any action by the Association is required.

(Govt. Ex. 27.) The management letter recommended that the bank determine "the adequacy of its allowance for loan losses on a quarterly basis." (*Id.*)

Germania's Audit Committee and its Board of Directors reviewed in a June 18, 1987 meeting the recommendations made in Peat Marwick's management letter. The Board then responded to the concerns of its auditor in a letter to the Federal Home Loan Bank of Chicago ("FHLB"), which had federal regulatory authority over Germania:

> Subsequent to year-end, management of the Association and representatives of Peat, Marwick, Main & Co. developed procedures to

> determine the adequacy of the Association's allowance for loan losses in response to recent accounting and SEC literature. The analysis attempts to classify the Association's portfolio into three categories (1) not a problem, (2) potential problem, and (3) high risk. Management of the Association, on a quarterly basis, will utilize this classification to assign a probable loss for loans included in each of these categories. Management of the Association will continue to improve the procedures utilized during Peat, Marwick's year-end evaluation of the Association's loan portfolio and real estate owned in determining the adequacy of its allowance for loan losses. It is management's intent to submit an analysis of its loan loss provision review to the Loan Committee on a quarterly basis for their review and discussion.

(Govt. Ex. 28.) The Board offered a similar response on August 20, 1987 to a "report of examination" and "comment letter" that the bank had received from the FHLB. (Govt. Ex. 32.) That response reviewed the status of specific problem loans referenced in the report and then described procedures the bank had implemented to more effectively monitor its loan portfolio. The Board reported that it had developed enhanced procedures "to more effectively monitor and identify problem and potential problem loans." (*Id.*) Moreover, the Board explained that on a quarterly basis, "a report is submitted by management to the Bank's Board of Directors and its outside auditors which evaluates the adequacy of the Bank's allowance for loan losses." (*Id.*) The Board also represented that as of August 11, 1987, its management had completed a review of fifty percent of those loans in its portfolio that exceeded $1 million.

B.

In early 1987, as the bank was in the process of responding to the concerns of its auditor and of federal regulators, Morris proposed to Germania's Board that the bank undertake the Schnote offering. He initially explored such an offering with outside underwriters but ultimately determined that Germania could conduct the offering itself. New was given the task of overseeing preparation of the Schnote offering circular, which ultimately disclosed the following about Germania's loan loss reserves:

> It is not presently possible to determine the actual losses that will ultimately be incurred by the Savings Bank in connection with the collection of its loan portfolio and liquidation of real estate owned; *however, the Savings Bank believes that, based on its present analysis, adequate provision has been made for estimated losses from these portfolios.* However, no assurance can be given that additional provisions for losses on loans and real estate owned will not be required as the result of future economic conditions or other factors.

(Gardner Ex. 7A, at 10 (emphasis added).) Consistent with the recommendation of Peat Marwick and Germania's own representations to the FHLB, the circular also revealed that bank management was submitting to the Board of Directors on a quarterly basis a report evaluating the adequacy of its allowance for loan losses. (*Id.* at 43.) The first Schnote sales in connection with this offering circular were recorded in October 1987, and the $10 million offering continued into March of the following year.

At the same time that management was preparing for the Schnote offering, Morris asked New to compile the September Analysis, which New characterized as "management's quarterly risk analysis assessment of the portfolio" as of

August 31, 1987. (*See, e.g.*, Tr. vol. III, at 383.) Morris' request came in response to Peat Marwick's recommendation that a quarterly analysis be done, and the bank's own representation to federal regulators that such an analysis would be performed. New testified that the SA also would enable management to ensure that the Schnote offering circular accurately reported the bank's financial condition. That circular, as we have noted, disclosed to investors that bank management was submitting such an analysis to the Board on a quarterly basis. The overall purpose of the SA, according to New, was "to make adequate provision for loan losses." (Tr. vol. III, at 385.)

New testified that as the bank's first quarterly analysis of its loan portfolio, the SA was a much more detailed analysis than anything the bank had previously undertaken. He described it as more detailed than the analysis done the previous year in connection with the public stock offering. To gather information for the analysis, New directed all of the bank's commercial loan officers and residential lenders to analyze their segments of the portfolio and to determine probable or expected losses from individual loans. Much of the supporting documentation used for this purpose had been compiled during the first two quarters of 1987, but the most intensive work on the September Analysis itself occurred in a period of approximately three weeks in early September.

On September 22, 1987, New met with Morris and Gardner to review the SA and to discuss the recommendation they would make to the Executive Committee about expected losses in the loan portfolio. New, Morris, and Gardner reviewed all of the supporting documentation underlying the analysis and also discussed its methodologies and conclusions. According to New, the three unanimously agreed in the course of this meeting that they would recommend to the Executive Committee an expected loss figure of approximately $18.6 million, which would exceed the bank's August 31, 1987 loss reserves by approximately $9.3 million. New indicated that the

$18.6 million figure represented neither a best nor a worst case scenario, but the scenario that was "expected" at the time. The worst case scenario reflected in the SA would have required loss reserves in the range of $22 to $23 million.

Management presented its recommendations to the Executive Committee of Germania's Board at a September 26, 1987 meeting. At the time, the committee was comprised of Morris, Gardner, New, Joseph L. Mason, and Weldon Rogers. The SA had been disseminated to Mason and Rogers prior to the meeting,[4] and Morris asked New to discuss its details for the committee. New testified that he had just begun to summarize the report when Mason, a real estate developer who was Germania's controlling shareholder and who had named Morris to the Board, "threw the document on the table" and said that "there is no fucking way we are going to take any more of these reserves at this time." (Tr. vol. III, at 395.) According to New, a silence descended over the room, and everyone seemed to wait for someone else to respond. New finally told Mason that management was recommending additional reserves in part because over $1 million in specific losses had already been identified in the portfolio by the bank's commercial loan officers. Mason retorted that he had "forgotten more about real estate than [New would] ever know." (*Id.*)[5]

In articulating his opposition to the SA's recommendations, Mason cited, among other things, a recent

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[4] In a memo notifying committee members of the meeting, Morris had provided a brief agenda and had observed that "the majority of the time will be spent looking at management's proposals for reducing overhead and for additional loan loss provisions." (Govt. Ex. 120.)

[5] Although Mason served as a consultant on the bank's commercial real estate loan portfolio, he did not play a day-to-day role in managing the portfolio. He knew less about specific aspects of the portfolio than the loan officers who had prepared the SA's recommendations. New testified that to his knowledge, Mason had never inspected many of the properties that were the subject of Germania loans.

audit report by Peat Marwick and an examination by Kenneth Levanthal & Co., both of which had found the bank's reserves to be within an acceptable range. New testified that these examinations were far less detailed than the SA, however; indeed, Kenneth Levanthal had examined only thirteen of the thousands of loans in Germania's portfolio. The documentation supporting the SA's recommendation of $9.3 million in additional reserves was not specifically discussed at the meeting. Mason also provided little specific direction as to what should be done to improve the SA, although he did direct New to obtain additional appraisals in connection with the next quarterly analysis.[6] Later in the meeting, Mason emphasized that the bank had to consider the impact on its shareholders (of which he was the largest) of taking such a large loan loss reserve at any one time. At another point, the committee's discussion turned to Germania's level of profitability for the quarter ending September 31, 1987. Due to the impending Schnote offering, it was important to Mason that the bank record a profit for that quarter. Had the committee approved management's loss reserve recommendation, the bank would have recorded a third-quarter loss of approximately $9 million.

At the conclusion of the discussion, the committee approved only $1.2 million in additional reserves, which enabled the bank to record a quarterly profit of slightly over $100,000. Those reserves were required to cover existing losses that the SA had identified in the portfolio. The committee directed management to continue to recommend additional reserves over time. New testified at trial that in the course of the meeting, neither Morris nor Gardner had attempted to defend the SA's recommendation once Mason voiced his objections. He also

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[6] New testified, however, that only one or two additional appraisals were actually conducted in putting together the next quarterly analysis in December 1987. Neither appraisal affected the bank's December 1987 evaluation of the affected loans.

testified that Mason said nothing in the meeting to convince him, as the bank's chief financial officer, that management's "expected loss" recommendation had been erroneous. Indeed, New told his wife after the meeting that the bank had made a very bad mistake that day.

The following week, Morris, Gardner, and New convened to discuss the results of the September 26 meeting. According to New, Gardner initially suggested that the SA and its underlying documentation be destroyed. New objected, observing that destruction of the analysis would be improper and that too many employees already had access to its supporting materials. Morris apparently agreed, and New then asked whether he should discuss the analysis with Peat Marwick's auditors, who would soon be reviewing the bank's third-quarter financial statements. New was told not to disclose the SA to Peat Marwick because bank management had ultimately adopted a much lower estimate of expected losses than that reflected in the SA; thus, the SA's recommendations were no longer those of bank management.[7]

In connection with Peat Marwick's review of the bank's third-quarter financial statements, however, Morris, Gardner, and New signed a representation letter affirming to Peat Marwick that the bank had made available to it all financial records and related data relevant to the quarterly review of the bank's financial statements. New testified that Peat Marwick should have received the SA in connection with that review because the SA reflected "management's recommendation going into the September 26th meeting of the expected losses [in the

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[7] New testified that he adhered to these instructions and did not provide the SA to Peat Marwick in connection with its review of the third-quarter financial statements. Yet New did later offer the SA to a Peat Marwick auditor, apparently in connection with Peat Marwick's 1987 year-end audit. That offer was declined, however, as Peat Marwick wanted to conduct its own analysis of Germania's loan portfolio. (See Tr. vol. IV, at 530-31.)

loan portfolio], and it would have had a significant impact on their analysis during the quarterly review." (Tr. vol. III, at 411.) The Peat Marwick partner in charge of the Germania engagement agreed, testifying that the SA was the type of document he would have expected to receive from the bank to support its financial statements. Having no knowledge of the SA, however, Peat Marwick approved Germania's third-quarter financial statements, and they were then placed in the back cover of the Schnote offering circular.

Bank management similarly represented in a debenture purchase agreement between Germania and Laclede Development Company ("Laclede") that "to the best knowledge of the bank, there is no fact relating to the bank or its subsidiaries which the bank has not disclosed to you in writing which materially affects adversely or will materially affect adversely the properties, profits, or condition of the bank and its subsidiaries taken as a whole." (Govt. Ex. 44, at 6.) New testified that this was not a truthful statement at the time because the bank had not disclosed the SA to Laclede in the course of its due diligence examination. Laclede's chief executive officer testified with assurance that the level of additional reserves recommended by the SA had not been disclosed to his company because "that would have blown the deal." (Tr. vol. VI, at 1022.) Germania's debenture purchase agreement with Laclede was disclosed in the Schnote offering circular and was a component of the bank's campaign to market its Schnotes.

In January 1988, prior to Peat Marwick's year-end audit for 1987, Germania's Board approved an additional $1.4 million in loan loss reserves. In a memo to Morris and Gardner dated February 2, 1988, New observed that he was "still very uncomfortable" with the level of the bank's reserves, and he indicated that Germania would have difficulty getting Peat Marwick to approve the reserve levels recommended by management. (Govt. Ex. 36.) After auditing the bank's

year-end financial statements, Peat Marwick recommended that Germania add between $6.5 and $13 million to its existing loan loss reserves. Although the need for these reserves was partially attributable to regulatory changes and to changes in certain of Peat Marwick's policies for valuing portions of the portfolio, the auditor's overall assessment of those portions of the portfolio analyzed by bank management in the SA were similar to the SA's recommendations.

When Peat Marwick's recommendations were presented to the bank's Audit Committee, its members interrogated bank management and the auditors about the reasons for such a dramatic increase in loan loss reserves. Committee members were primarily interested in learning what had caused the need for additional reserves and when management had learned that the bank was under-reserved. In the course of these discussions, neither Morris nor Gardner disclosed that bank management had earlier recommended comparable reserves to the Executive Committee.

Germania's Board ultimately approved $9.4 million in additional reserves for the year ending December 31, 1987, and Germania publicly announced those reserves in February 1988, after suspending the ongoing Schnote offering. Bank management and the Audit Committee discussed rescinding the Schnote sales made prior to the announcement, but they ultimately decided to amend the offering circular and to proceed with the offering. When it renewed the offering, the bank assured investors that the 1987 losses did not affect the safety of their Schnotes. Germania employees were encouraged, moreover, to tell customers that the bank had not actually lost the $9.4 million, but that it had merely moved the funds to a reserve account, which served to protect the bank and its Schnotes. Germania raised an additional $1 million upon renewal of the Schnote offering.

C.

After a lengthy investigation, Morris and Gardner were

charged with two counts of mail and one count of wire fraud in connection with the Schnote offering. The wire fraud charge concerned a toll free "hot line" the bank had established in marketing the Schnotes, whereas the mail fraud counts concerned, respectively, an unsolicited mass mailing promoting the Schnotes to approximately 18,000 Germania customers in January 1988, and a February 1988 sale of an $18,000 Schnote to a local chapter of the Disabled American Veterans. A jury convicted Morris and Gardner on all charges, and the district court subsequently imposed prison sentences on each of forty-six months.

II. DISCUSSION

A.

The mail and wire fraud statutes are addressed to "any scheme or artifice to defraud" executed through the appropriate communications medium. 18 U.S.C. §§ 1341 & 1343. To establish a violation of either statute, the government must prove the existence of such a scheme and a use of the mails or communication wires, as the case may be, for the purpose of executing or attempting to execute the scheme. *See, e.g., Schmuck v. United States*, 489 U.S. 705, 721, 103 L. Ed. 2d 734, 109 S. Ct. 1443 (1989); *United States v. Ross*, Nos. 92-1449 & 92-1685, slip op. at 20, 1996 WL 41564 (7th Cir. Feb. 2, 1996); *United States v. Briscoe*, 65 F.3d 576, 583 (7th Cir. 1995). Morris and Gardner argue that the government proved neither mail nor wire fraud in connection with the Schnote offering because it never established the existence of an intentional scheme to defraud. In considering that argument, which essentially is a challenge to the sufficiency of the supporting evidence at trial, we construe the evidence in the light most favorable to the government and consider whether any rational jury could have found the existence of such a scheme beyond a reasonable doubt. *See Jackson v. Virginia*, 443 U.S. 307, 316, 61 L. Ed. 2d 560, 99 S. Ct. 2781 (1979); *United States v. Catalfo*, 64 F.3d 1070, 1076 (7th Cir. 1995).

As used in the mail and wire fraud statutes, the term "scheme to defraud" encompasses "any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations, or promises." *Carpenter v. United States,* 484 U.S. 19, 27, 98 L. Ed. 2d 275, 108 S. Ct. 316 (1987); *see also Richards v. Combined Ins. Co. of Am.,* 55 F.3d 247, 252 (7th Cir. 1995). It therefore encompasses fraudulent schemes premised on false statements or factual misrepresentations. *See McNally v. United States,* 483 U.S. 350, 359, 97 L. Ed. 2d 292, 107 S. Ct. 2875 (1987); *United States v. Keplinger,* 776 F.2d 678, 698 (7th Cir. 1985), *cert. denied,* 476 U.S. 1183, 91 L. Ed. 2d 548, 106 S. Ct. 2919 (1986). As we recently had occasion to explain in a civil RICO suit, the mail and wire fraud statutes broadly apply to any scheme "where in order to get money or something else of monetizable value from someone you make a statement to him that you know to be false, or a half truth that you know to be misleading, expecting him to act upon it to your benefit and his detriment." *Emery v. American Gen. Fin., Inc.,* 71 F.3d 1343, 1346 (7th Cir. 1995). We reiterated, moreover, that the statutes apply not only to false or fraudulent representations, but also to the omission or concealment of material information, even where no statute or regulation imposes a duty of disclosure. *Id.* at 1346-47; *see also Biesiadecki,* 933 F.2d at 543; *Keplinger,* 776 F.2d at 697-98. Such a misleading omission is actionable as part of a scheme to defraud "if it is intended to induce a false belief and resulting action to the advantage of the misleader and the disadvantage of the misled." *Emery,* 71 F.3d at 1348.

B.

The government's theory at trial was that the entire Schnote offering had been designed by bank management to defraud potential investors. At the heart of the government's case was the representation in the Schnote offering circular that based upon its present analysis, bank management believed that it had made adequate provision for losses in the loan portfolio.

That statement was false or misleading, according to the government, because it omitted any mention of the approximately $8 million in additional losses that bank management fully expected after compiling the September Analysis. Indeed, management recommended to Germania's Executive Committee that reserves be taken in the third quarter of 1987 to cover those losses. The committee rejected that recommendation, according to the government, not because it considered the recommendation to be erroneous, but because the bank's majority shareholder wanted Germania to show a profit for the quarter immediately preceding the Schnote offering. To conceal its fraud, then, bank management allegedly failed to disclose the SA to auditors conducting a review of the bank's quarterly financial statements or to Laclede's due diligence examiners in connection with the Germania-Laclede debenture purchase agreement.

In attacking the sufficiency of the evidence supporting this fraud theory, defendants make a series of arguments. First, they attempt to discredit the SA itself, calling it a "rough first draft" and a "worst-case scenario" that was never intended to reflect management's current position on necessary reserves. Yet the jury's verdict necessarily precludes us from accepting this argument. Although Morris and Gardner testified that the SA was indeed a hastily prepared first draft filled with typographical errors, that it was merely a discussion document, and that it reflected a worst-case assessment of possible losses in the portfolio over time, those assertions were flatly contradicted by Germania's chief financial officer Jimmie New, who had overseen the SA's preparation. New told the jury that the SA was "management's quarterly risk analysis assessment of the portfolio" as of August 31, 1987 (*see, e.g.*, Tr. vol. III, at 383), and that the bank had prepared the report to comply with its auditor's recommendation and the bank's own representation to federal regulators that it performed a quarterly analysis of its

loan portfolio.[8] New indicated that the $18.6 million loss figure in the SA reflected neither a best nor a worst case scenario; instead, he described it as management's best estimate of "expected" losses in Germania's portfolio. New explained to the jury, moreover, that he had met with Morris and Gardner on September 22, 1987 to discuss the SA's recommendations, and that the three had unanimously agreed to recommend to the Executive Committee that it approve additional loss reserves of $9.3 million. Morris then disseminated the SA to committee members along with an agenda for the September 26 meeting. In convicting defendants on all charges, the jury obviously believed New, not Morris and Gardner. We must accept the jury's resolution of this disputed factual issue, as we are in no position to reassess the credibility of New vis-a-vis that of defendants. *See Ross,* Nos. 92-1449 & 92-1685, slip op. at 22-23; *Folger Adam Co. v. PMI Indus., Inc.,* 938 F.2d 1529, 1534 (2d Cir.) (resolution of dispute over proper characterization of internal reports is for the jury), *cert. denied,* 502 U.S. 983, 116 L. Ed. 2d 612, 112 S. Ct. 587 (1991). We must therefore assume that the SA was indeed management's risk analysis of the loan portfolio for the third quarter of 1987. We must also assume, consistent with New's testimony, that Morris and Gardner agreed with the expected loss figure reflected in that analysis and in fact recommended to the Executive Committee that reserves be taken immediately to cover those losses.[9]

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[8] The Schnote offering circular itself disclosed to potential investors that bank management was submitting to the Board of Directors on a quarterly basis a report evaluating the adequacy of its allowance for loan losses. (*See* Gardner Ex. 7A, at 10.)

[9] As the government points out, if the SA were merely a rough first draft setting out a worst-case scenario of reserves the bank might choose to take over time, Mason's explosion at the September 26, 1987 meeting would make little sense. According to New, Mason emphatically stated that the bank would not be taking "any more of these reserves at this time." (Tr. vol. III, at 395 (emphasis added).)

For this reason, defendants' reliance on such cases as *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989), and *Panter v. Marshall Field & Co.*, 646 F.2d 271, 293 (7th Cir.), *cert. denied*, 454 U.S. 1092, 70 L. Ed. 2d 631, 102 S. Ct. 658 (1981), is unavailing. In those cases, we agreed with the defendants that a company need not disclose a tentative internal estimate that conflicts with published figures unless the internal estimate is made with such a reasonable degree of certainty that it reveals the published figures to be materially misleading. *Wielgos*, 892 F.2d at 516; *Panter*, 646 F.2d at 292. We have reaffirmed that rule in a series of recent cases. *See, e.g., In re HealthCare Compare Corp. Sec. Litig.*, 75 F.3d 276, 282-83 (7th Cir. 1996) (following *Wielgos* and *Panter*); *Searls v. Glasser*, 64 F.3d 1061, 1067 (7th Cir. 1995) (same). In the cited cases, however, the character of the internal reports at issue was not seriously disputed, as the plaintiffs had been unable to produce evidence sufficient to contradict the "tentative" characterization placed on those estimates by the company itself. We could thus determine as a matter of law that the defendants need not have disclosed the tentative estimates because they were not so certain as to reveal the company's published figures to be materially misleading. *See Wielgos*, 892 F.2d at 516; *Panter*, 646 F.2d at 292-93. Here, however, the government was able to show that the SA's estimate of "expected" losses in the loan portfolio was reasonably certain. The government established that the SA's estimates had been embraced by Morris and Gardner, who recommended to Germania's Executive Committee that reserves be taken to cover those expected losses. It established, moreover, that the Executive Committee rejected the recommended reserves not because of any defect in the SA's estimates, but because Germania's majority shareholder insisted that the bank show a profit in the quarter preceding the Schnote offering. The government's evidence apparently persuaded the jury that the SA in fact contained estimates of expected losses in the loan

portfolio that bank management considered to be reasonably certain. That was an issue for the jury to decide, and its decision cannot be considered erroneous as a matter of law. *See Folger Adam Co.*, 938 F.2d at 1534 & n.8 (distinguishing Wielgos and Panter and leaving proper characterization of internal reports to the jury); *see also Schwartz v. System Software Assoc., Inc.*, 32 F.3d 284, 287-88 (7th Cir. 1994) (jury resolved dispute over whether three internal reports were true forecasts or worst-case simulations).

C.

Having cleared those preliminary hurdles, we get to the heart of defendants' argument--that bank management did not engage in an intentional scheme to defraud because it had a reasonable basis for rejecting the SA's recommendations and for describing the bank's existing reserves as "adequate." According to defendants, the government proved only that the offering circular's "prediction" about the adequacy of loan loss reserves was erroneous in light of later events, not that its prediction was the primary component of an intentional scheme to defraud. Because defendants allegedly had a reasonable basis for their description of loss reserves in the offering circular, they deride the government's case as a classic example of "fraud by hindsight."

In considering similar fraud claims based upon management's characterization of the adequacy of loan loss reserves, our colleagues in other circuits have been guided by the Supreme Court's decision in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 115 L. Ed. 2d 929, 111 S. Ct. 2749 (1991). *See, e.g., In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 927 (9th Cir. 1993), *cert. denied*, 115 S. Ct. 295 (1994); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 282-83 (3d Cir.), *cert. denied*, 506 U.S. 934, 121 L. Ed. 2d 278, 113 S. Ct. 365 (1992). Sandberg did not involve a bank's characterization of the adequacy of its loan loss reserves, but we agree that its analysis is applicable to such a statement. *See, e.g., In re Westinghouse Sec. Litig.*, 832

F. Supp. 948, 971 (W.D. Pa. 1993) ("characterizations of reserves as adequate are necessarily a matter of opinion and belief" under *Sandberg*).

The Court in *Sandberg* considered whether a statement of opinion or belief could be materially misleading and thus actionable under section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a), and SEC Rule 14a-9. The statement at issue appeared in a company's proxy materials and delineated for shareholders management's reasons for approving a merger proposal. The proxy materials explained that the proposal offered shareholders the opportunity "to achieve a high value for their shares" and that its terms were "fair." *Id.* at 1090 (internal quotation omitted). When a disgruntled shareholder alleged that these statements were fraudulent, the defendants argued that such statements of opinion and belief are not actionable under the securities laws because they are not "factual" statements subject to verification. The Supreme Court disagreed, finding defendants' statements to be "factual in two senses: as statements that the directors do act for the reasons given or hold the belief stated and as statements about the subject matter of the reason or belief expressed." *Id.* at 1092. Although the Court agreed that management's statements were conclusory statements of opinion, it explained that such statements "are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading." *Id.* at 1093. Whether a conclusory statement is accurate or misleading, moreover, is subject to proof by reference to historical facts:

> Provable facts either furnish good reasons to make a conclusory commercial judgment, or they count against it, and expressions of such judgments can be uttered with knowledge of truth or falsity just like more definite statements, and defended or attacked through the orthodox evidentiary process that either

> substantiates their underlying justifications or tends to disprove their existence.

Id. The Court therefore concluded that plaintiffs in such cases must be permitted to prove that a conclusory statement of opinion was "knowingly false or misleadingly incomplete" when made. *Id.* at 1095.

In *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 282-83 (3d Cir.), *cert. denied*, 506 U.S. 934, 121 L. Ed. 2d 278, 113 S. Ct. 365 (1992), the Third Circuit likened a bank's characterization of the adequacy of its loan loss reserves to management's conclusory reasons for approving the merger proposal in the *Sandberg* proxy statement. The court believed that by affirmatively characterizing a management practice as "adequate," a defendant puts that particular subject matter "in play" under the securities laws:

> If a defendant represents that its lending practices are "conservative" and that its collateralization is "adequate," the securities laws are clearly implicated if it nevertheless intentionally or recklessly omits certain facts contradicting these representations. Likewise, if a defendant characterizes loan loss reserves as "adequate" or "solid" even though it knows they are inadequate or unstable, it exposes itself to possible liability for securities fraud. By addressing the quality of a particular management practice, a defendant declares the subject of its representation to be material to the reasonable shareholder, and thus is bound to speak truthfully.

Id. at 282. The Third Circuit reaffirmed that holding in *Hayes v. Gross*, 982 F.2d 104, 106-07 (3d Cir. 1992), concluding there that the plaintiff had stated a "paradigm case" of securities fraud when he alleged that officers and directors had known of the inadequacy of a bank's loss reserves but had represented in an

annual report that reserves were maintained at a level considered "adequate" by management to provide for potential losses in the portfolio.

In both *Shapiro* and *Hayes*, however, the Third Circuit was careful to distinguish claims based upon management's characterization of the adequacy of reserves from those claims alleging merely a failure to provide for adequate reserves, a form of mismanagement that generally is not considered fraudulent. *Hayes*, 982 F.2d at 106; *see also Shapiro*, 964 F.2d at 281. As Hayes explained:

> An allegation of mismanagement on the part of a defendant will not alone support a claim [for securities fraud]; nor will an allegation that a defendant failed to disclose the existence of mismanagement. . . . [A] complaint does allege an actionable misrepresentation if it alleges that a defendant was aware that mismanagement had occurred and made a material public statement about the state of corporate affairs inconsistent with the existence of mismanagement. A statement of opinion or belief, if known to be false, may be the basis of such a claim.

982 F.2d at 106.

The Ninth Circuit subsequently followed *Shapiro* and *Hayes* in *In re Wells Fargo Sec. Litig.*, 12 F.3d 922 (9th Cir. 1993), *cert. denied*, 115 S. Ct. 295 (1994). There, the plaintiff shareholders grounded their securities fraud claim against bank officers and directors on the representation in financial reports that management considered its present allowance for loan losses to be "adequate." *Id.* at 930. Although the reserves later proved grossly inadequate, the court explained that management's earlier statement would be actionable only if the contingencies that rendered the reserves inadequate "were foreseen or foreseeable." *Id.* at 927. The plaintiffs satisfied this test by alleging that the bank in fact knew of certain

contingencies that rendered its reserves inadequate but failed to disclose that information to investors. The plaintiffs' claim, then, was neither one of "second-guessing decisions by management nor one alleging 'fraud by hindsight'" because the plaintiffs had identified specific facts known to the defendants that had been omitted from a report which represented existing reserves as "adequate." *Id.* As in *Shapiro*, such a representation declares its subject to be material to the reasonable shareholder, binding the bank to speak truthfully. *Id.* at 930.

The First Circuit reached a similar conclusion in *Serabian v. Amoskeag Bank Shares, Inc.*, 24 F.3d 357 (1st Cir. 1994). There, too, a class of shareholders alleged that bank officers and directors had violated federal securities laws in describing the bank's loan review capabilities as "strong" and its allowance for loan losses as "sufficient" when those representations were inconsistent with internal information then available to bank management. *Id.* at 364-65. Plaintiffs' allegations were actionable, the court held, because they suggested that "the bank knew, or should have known, that its public statements were inconsistent with the actual conditions then being reported to them." *Id.* at 365 (emphasis in original).

From these cases, it is clear that Germania's characterization of the adequacy of its loss reserves is not immune from the government's fraud charge simply by virtue of the fact that it offers only the opinion of bank management on a debatable and indefinite matter. As *Shapiro* explained, "there is nothing unique about representations and omissions regarding loan loss reserves that removes them from the purview of the antifraud provisions of the federal securities laws." 964 F.2d at 281; *see also Wells Fargo,* 12 F.3d at 927. Although we can agree with defendants that the estimation of probable losses in a large loan portfolio like Germania's is more an art than a science, and that any two analyses of probable losses in the same portfolio are unlikely to exactly correspond, representations by management about the adequacy of reserves

still may be fraudulent if they are knowingly false or misleadingly incomplete. *See, e.g., Sandberg,* 501 U.S. at 1093, 1095; *Shapiro,* 964 F.2d at 281, 283; *In re Westinghouse Sec. Litig.,* 832 F. Supp. at 970-71. In that sense, the government must show that bank management did not truly believe in the adequacy of Germania's loss reserves and that its statement to the contrary was not supported by the available facts. *See Sandberg,* 501 U.S. at 1092, 1095-96; *Mayer v. Mylod,* 988 F.2d 635, 639 (6th Cir. 1993); *Hayes,* 982 F.2d at 106-07.

D.

It is true, as Morris and Gardner stress, that the government cannot establish fraud in the offering circular merely by pointing to the bank's announcement a short time later that an additional $9.4 million in reserves would be required. Our oft-cited decision in *DiLeo v. Ernst & Young,* 901 F.2d 624, 627 (7th Cir.), *cert. denied,* 498 U.S. 941, 112 L. Ed. 2d 312, 111 S. Ct. 347 (1990), establishes that the government's case would fail in that circumstance because nothing in its proof would suggest that the difference between management's assessment of probable losses at point A and point B was attributable to fraud, as opposed to mere mismanagement or some unforeseeable market force. *See also, e.g., Grassi v. Information Resources, Inc.,* 63 F.3d 596, 599 (7th Cir. 1995); *In re Glenfed, Inc. Sec. Litig.,* 42 F.3d 1541, 1548-49 (9th Cir. 1994) (*en banc*) ("The fact that an allegedly fraudulent statement and a later statement are different does not necessarily amount to an explanation as to why the earlier statement was false." (emphasis in original)); *Serabian,* 24 F.3d at 361, 367; *Wells Fargo,* 12 F.3d at 927-28; *Eckstein v. Balcor Film Investors,* 8 F.3d 1121, 1132 (7th Cir. 1993), *cert. denied,* 127 L. Ed. 2d 78, 114 S. Ct. 883 (1994); *Arazie v. Mullane,* 2 F.3d 1456, 1467-68 (7th Cir. 1993). Had that been the sum of the government's case here, we could agree that at most, it would have proven mismanagement, which is not the equivalent of fraud. *See, e.g., Hayes,* 982 F.2d at 106; *Shapiro,* 964 F.2d at 281.

But the government did not merely contrast the characterization of reserves in the offering circular with the auditor's recommendations in February of the following year. Rather, consistent with the case law, the government pointed to information known to bank management at the time of the Schnote offering which indicated that the offering circular's characterization of the adequacy of reserves was without a legitimate factual basis. *See Sandberg,* 501 U.S. at 1093; *Glenfed Sec. Litig.,* 42 F.3d at 1548-49; *Serabian,* 24 F.3d at 365; *Wells Fargo,* 12 F.3d at 927-28; *DiLeo,* 901 F.2d at 626-27. That is precisely the sort of internal information the courts look to in assessing whether a statement of opinion or belief in a public document could be considered fraudulent. The Ninth Circuit has observed, for example, that an allegedly fraudulent statement could be proven untrue or misleading when made "by pointing to inconsistent contemporaneous statements or information (such as internal reports) which were made by or available to the defendants." *Glenfed Sec. Litig.,* 42 F.3d at 1549; *see also Serabian,* 24 F.3d at 365. The government pointed to both types of evidence here, as it relied on the SA's conclusion that a dramatic increase in reserves was necessary to cover expected losses in the loan portfolio, and on New's testimony that both Morris and Gardner had agreed with the SA's recommendations prior to the September 26, 1987 meeting of Germania's Executive Committee. This evidence could suggest to a reasonable jury that bank management did not truly believe that existing reserves were adequate and that its statement to the contrary in the offering circular was not supported by the available facts. *See Sandberg,* 501 U.S. at 1092, 1095-96; *Mayer,* 988 F.2d at 639.

Morris and Gardner argue, however, that even if they had agreed to recommend the level of reserves reflected in the SA, that recommendation was rejected by the Executive Committee in good faith after it had examined and discussed the SA in the course of its September 26 meeting. Defendants'

good faith in describing existing reserves as adequate would constitute a complete defense to the mail and wire fraud charges here because if they genuinely believed in the truth of the offering circular's statement, the intent to defraud required for a conviction on such charges would be absent. *See, e.g., United States v. Dunn*, 961 F.2d 648, 650 (7th Cir. 1992); *United States v. Alexander*, 743 F.2d 472, 478-79 (7th Cir. 1984).

But the nature of the Executive Committee's discussions at its September 26 meeting was, along with the proper characterization of the SA, one of the primary factual issues disputed at defendants' trial. Although Morris and Gardner insisted that the SA's recommendations were discussed and rejected on their merits, with Mason criticizing the SA's methodology and calling for additional information, New told a far different story. He indicated that there was little if any discussion of the SA's recommendations once Germania's majority shareholder voiced vehement opposition to taking reserves of the recommended magnitude at a time when the bank was preparing for a debt offering. Because the bank's financial statements for the third quarter of 1987 would be included in the Schnote offering circular, it was imperative to Mason that Germania record a profit for that quarter. Approval of the recommended reserves would have caused the bank to record a third-quarter loss of approximately $9 million. New also testified that neither Morris nor Gardner attempted to defend the level of reserves they had agreed to recommend once Mason voiced his opposition.

If New's version of the September 26 meeting is credited, a reasonable jury could conclude that the Executive Committee, which included Morris and Gardner, did not reject the SA's recommendations in good faith, but because Germania's controlling shareholder had insisted that the bank show a quarterly profit for purposes of its impending debt offering. Indeed, the jury was instructed at defendants' request that there was no fraud if defendants merely made an honest

mistake in judgment. (See Defendants' Instruction 7A.)[10] The jury, however, apparently concluded that the SA's recommendations had not been rejected in good faith and that the offering circular's characterization of the adequacy of reserves was therefore fraudulent. The evidence we have detailed amply supports those conclusions. *See Ross,* Nos. 92-1449 & 92-1685, *slip op.* at 22-23; *United States v. Ashman,* 979 F.2d 469, 480-81 (7th Cir. 1992), *cert. denied,* 114 S. Ct. 62 (1993); *Keplinger,* 776 F.2d at 698-99 (whether omission of consultant's contrary finding from a laboratory report was fraudulent was for the jury); *United States v. Sylvanus,* 192 F.2d 96, 105 (7th Cir. 1951) ("The question was whether, upon the whole record, the representations were fraudulently made, and this was a question for the jury."), *cert. denied,* 342 U.S. 943, 96 L. Ed. 701, 72 S. Ct. 555 (1952).[11]

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[10] That instruction provided in pertinent part as follows:

> The good faith of defendants Morris and Gardner is a complete defense to the charges of mail and wire fraud contained in the indictment because good faith on the part of the defendants is, simply, inconsistent with the intent to defraud alleged in that charge.
>
> A person who acts, or causes another person to act, on a belief or an opinion honestly held is not punishable under this statute merely because the belief or opinion turns out to be inaccurate, incorrect, or wrong. An honest mistake in judgment or an error in management does not rise to the level of intent to defraud. . . .

(Gardner Instruction 7A.)

[11] The jury could similarly infer from defendants' subsequent efforts to conceal the SA that its recommendations had not been rejected in good faith by the bank's Executive Committee. Assuming that New's testimony was credited, a reasonable jury could find that, Gardner suggested in the wake of the September 26 Executive Committee meeting that the SA be destroyed. Morris and New rejected that suggestion, but defendants then instructed New not to disclose the SA to Peat Marwick in connection with its quarterly review of the bank's financial statements. New assumed from this instruction that he also should not disclose the SA to Laclede's due diligence examiners in

E.

Defendants make one final argument addressed to the legal sufficiency of their convictions. They point to other language in the offering circular which allegedly modifies the loan loss reserve statement and contend that this language neutralized any fraud. They point, for example, to the sentences that preceded and that followed the "adequacy" statement:

> *It is not presently possible to determine the actual losses that will ultimately be incurred by the Savings Bank in connection with the collection of its loan portfolio and liquidation of real estate owned;* however, the Savings Bank believes that, based on its present analysis, adequate provision has been made for estimated losses from these portfolios. *However, no assurance can be given that additional provisions for losses on loans and real estate owned will not be required as a result of future economic conditions or other factors.*

(Gardner Ex. 7A, at 10 (emphasis added).) They also highlight the offering circular's disclosure of 1986 loan loss reserves (*Id.* at 10, 43), of the "greater risk" present in the bank's commercial and multi-family residential loans (*Id.* at 11), and of the impact of a potential regulatory change on the bank's classification of certain loans (*Id.* at 12). Defendants maintain that these disclosures, which reveal the uncertainty of predicting losses in any portfolio and of the risks inherent in Germania's particular portfolio, modify the circular's "adequacy" statement and thus "bespeak caution" to the ordinary investor. They argue that under the "bespeaks caution" doctrine, the circular's

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connection with the Germania Laclede debenture purchase agreement. Witnesses from both Peat Marwick and Laclede testified at trial that a report such as the SA should have been disclosed by bank management in the course of their examinations.

characterization of the adequacy of reserves was not materially misleading because, when considered with the offering circular's other disclosures, that statement could neither have been designed to mislead nor could it have misled the ordinarily prudent investor.

We recently had occasion to address a similar invocation of the "bespeaks caution" doctrine in a civil securities fraud case. *See Harden v. Raffensperger, Hughes & Co.*, 65 F.3d 1392, 1404-1406 (7th Cir. 1995). There, we characterized the doctrine in this way: "'When forecasts, opinions, or projections in a disclosure statement are accompanied by meaningful warnings and cautionary language, the forward-looking statements may not be misleading. The substantial disclosure of specific risks may render alleged misrepresentations concerning soft information immaterial and thus nonactionable as securities fraud.'" *Id.* at 1404 (quoting 3B Harold S. Bloomenthal, *Securities and Federal Corporate Law* § 8.26[1], at 8-110 (1995)). We also observed that when the doctrine is properly construed, it "'merely represents the pragmatic application of two fundamental concepts in the law of securities fraud: materiality and reliance.'" *Id.* at 1404-05 (quoting *In re Worlds* of Wonder Sec. Litig., 35 F.3d 1407, 1414 (9th Cir. 1994), *cert. denied*, 116 S. Ct. 185, 277 (1995)); *see also Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994) ("The 'bespeaks caution' doctrine merely reflects the unremarkable proposition that statements must be analyzed in context."). We noted that a number of other circuits have approved some variation on the doctrine, and that the Supreme Court has implicitly accepted its logic. *See Harden*, 65 F.3d at 1405 & nn. 9-10; *see also Sandberg*, 501 U.S. at 1097; *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 372 (3d Cir. 1993), *cert. denied*, 114 S. Ct. 1219 (1994). Although Harden implicitly recognizes the viability of the "bespeaks caution" doctrine in this circuit as a defense in securities fraud cases, we have yet to encounter a case where the doctrine applied to negate the materiality of a misleading

statement as a matter of law. *See Harden,* 65 F.3d at 1405-06 & n.11; *Roots Partnership v. Lands' End, Inc.,* 965 F.2d 1411, 1417 (7th Cir. 1992).

Assuming that the "bespeaks caution" doctrine could provide a valid defense to mail and wire fraud charges, it does not provide a basis for overturning the convictions of these defendants. Harden explained that the effect of cautionary language on an otherwise misleading statement must be assessed on a case-by-case basis. 65 F.3d at 1404. Vague or boilerplate disclaimers advising that a particular investment has risks generally will not suffice; instead, the cautionary language "must be substantive and tailored to the specific future projections, estimates or opinions" that are alleged to be misleading. *In re Trump,* 7 F.3d at 371-72; *see also Harden,* 65 F.3d at 1404. In *Sandberg,* moreover, the Supreme Court observed that "not every mixture with the true will neutralize the deceptive. If it would take a financial analyst to spot the tension between the one and the other, whatever is misleading will remain materially so . . . ." *Id.* It is only "when the inconsistency would exhaust the misleading conclusion's capacity to influence" the reasonable investor that the conclusion will be rendered immaterial. *Id.* at 1097-98; *see also Fecht v. Price Co.,* 70 F.3d 1078, 1082 (9th Cir. 1995), *petition for cert. filed,* No. 95-1347 (U.S. Feb. 20, 1996).

The language relied upon by defendants here does nothing more than to apprise potential investors that actual losses in the portfolio cannot now be predicted with absolute certainty. Even while noting the possibility that "future economic conditions or other factors" such as a regulatory change may require the bank to take additional reserves in the future, the offering circular still advises that "based on its present analysis," bank management believes that "adequate provision" has been made for estimated losses in the loan portfolio. The uncertain nature of predicting future loan losses does not neutralize the misleading character of this statement when the government proved to the jury's satisfaction that

management's "present analysis" (the SA) actually recommended the doubling of existing reserves. The qualifying statements thus do not exhaust the capacity of the adequacy statement to mislead. *See Sandberg,* 501 U.S. at 1097-98; *Harden,* 65 F.3d at 1405-06; *Roots Partnership,* 965 F.2d at 1417 (declining to apply doctrine to forward-looking statements about corporation's goals).[12]

III.

Morris and Gardner alternatively argue that they are entitled to a new trial because the government suppressed material exculpatory information in violation of its obligations under *Brady v. Maryland,* 373 U.S. 83, 10 L. Ed. 2d 215, 83 S. Ct. 1194 (1963). Defendants did not raise any Brady issues prior to or during their trial but instead argued in a series of post-trial motions that the government had suppressed certain materials they considered to be exculpatory. After two separate evidentiary hearings, the district court found that no *Brady* violation had occurred, and the court therefore refused to grant defendants a new trial. In so ruling, the district court did not determine whether the items referenced by defendants were in fact exculpatory; instead, the court concluded that defendants

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[12] In addition to the offering circular, there also was substantial evidence at trial addressed to the way in which Germania had marketed its Schnotes to potential investors. The government focused on two internal sales contests designed by Germania for its employees and argued that the bank used high pressure tactics to convince risk-averse, unsophisticated depositors to purchase Schnotes. The government maintained that Germania's marketing materials also were misleading because they characterized the noninsured Schnotes as a "safe" investment. Defendants countered that their marketing campaigns adequately disclosed the risks associated with the Schnotes and therefore were not fraudulent.

Because a reasonable jury could conclude that the offering circular's description of the adequacy of loan loss reserves was fraudulent, we need not consider whether Germania's marketing campaigns were fraudulent independent of the material misrepresentations in the offering circular.

had failed to show that the government's prosecution team had been aware of the existence of the allegedly suppressed documents. In that respect, the court emphasized that there were literally hundreds of boxes of documents potentially relevant to this case and that the government had provided defendants and their counsel free and open access to all of those documents.[13] To the extent defendants were alleging that certain documents had not been specifically identified by the government as exculpatory, the court believed that the government also had been unaware of the existence of those documents. The court emphasized, moreover, that defendants had been given the same opportunity as the government to discover the identified documents.

In *Brady,* the Supreme Court held that "the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith of the prosecution." 373 U.S. at 87; *see also Kyles v. Whitley,* 131 L. Ed. 2d 490, 115 S. Ct. 1555, 1565 (1995). Before they would be entitled to a new trial under *Brady,* however, Morris and Gardner must establish: "(1) that the prosecution suppressed evidence; (2) that the evidence was favorable to the defense; and (3) that the evidence was material to an issue at trial." *United States v. Silva,* 71 F.3d 667, 670 (7th Cir. 1995); *see also United States v. Young,* 20 F.3d 758, 764 (7th Cir. 1994). The district court determined that the government had not "suppressed" the evidence identified by defendants even if that evidence could be considered both favorable and material. We

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[13] The RTC maintained a depository of Germania documents that included more than 700 boxes and that generally was open and available to litigants and their counsel in this criminal prosecution and in the numerous civil lawsuits against these defendants arising from Germania's demise. (*See* Oct. 6, 1994 Tr. vol. I, at 15; Oct. 6, 1994 Tr. vol. II, at 35-36.)

agree with that conclusion and thus with the district court's decision to deny defendants a new trial.

As a general rule, the government's obligation to disclose exculpatory or impeaching information under *Brady* is limited to that information which is then known to the government. *See United States v. Moore,* 25 F.3d 563, 569 (7th Cir.), *cert. denied,* 115 S. Ct. 341 (1994); *Young,* 20 F.3d at 764; *Mendoza v. Miller,* 779 F.2d 1287, 1297 (7th Cir. 1985), *cert. denied,* 476 U.S. 1142, 90 L. Ed. 2d 697, 106 S. Ct. 2251 (1986). Although we have not interpreted *Brady* as requiring prosecutors to affirmatively seek out information not presently in their possession (*see Moore,* 25 F.3d at 569; *United States v. Romo,* 914 F.2d 889, 898 (7th Cir. 1990), *cert. denied,* 498 U.S. 1122, 112 L. Ed. 2d 1183, 111 S. Ct. 1078 (1991)), we have found it improper for a prosecutor's office to remain ignorant about certain aspects of a case or to compartmentalize information so that only investigating officers, and not the prosecutors themselves, would be aware of it. *See Carey v. Duckworth,* 738 F.2d 875, 877-78 (7th Cir. 1984); *see also Young,* 20 F.3d at 764. The district court concluded from these cases that *Brady* did not require the government here to seek out allegedly exculpatory information in the hands of the Office of Thrift Supervision ("OTS"), the Securities Exchange Commission ("SEC"), or the Internal Revenue Service ("IRS") when it had been unaware of the existence of that information.[14] Because none of those agencies were part of the team that

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[14] Specifically, the OTS had deposed New in August 1990 in conjunction with its investigation of Germania's demise. The SEC had in its possession questionnaires relating to a survey of Schnote purchasers that apparently had been conducted in conjunction with the SEC's investigation of the Schnote offering. That investigation was independent of that of the prosecutors here and resulted in separate litigation initiated by the SEC in 1990. The documents held by the IRS relate to a 1989 inquiry by that agency into the tax implications of Germania's high level of loan loss reserves.

investigated this case or participated in its prosecution, the district court would not impute their knowledge of potentially exculpatory information to the present prosecutors.

Morris and Gardner contend that the district court's decision is inconsistent with *Kyles v. Whitley,* 131 L. Ed. 2d 490, 115 S. Ct. 1555, 1567 (1995), because there, the Court imposed a duty on individual prosecutors "to learn of any favorable evidence known to the others acting on the government's behalf in the case, including the police." We do not agree, however, that *Kyles* is inconsistent with the rule articulated by the district court here, or for that matter with the previous decisions of this court. Indeed, this circuit has long followed a rule similar to that approved in *Kyles*; we held in *United States ex rel. Smith v. Fairman,* 769 F.2d 386, 391 (7th Cir. 1985), for instance, that the *Brady* rule is violated even where police, rather than prosecutors, are responsible for the suppression of exculpatory information. But neither *Kyles* nor *Fairman* can be read as imposing a duty on the prosecutor's office to learn of information possessed by other government agencies that have no involvement in the investigation or prosecution at issue. *Cf. Carey,* 738 F.2d at 878 (*Brady* obligation extends to members of the prosecution "team," which includes DEA and police). That is the only rule that would help defendants here, as they argue that the prosecutors had a duty to discover information in the hands of other government agencies that at various times conducted independent investigations of Germania's affairs. The district court was satisfied, as are we, that the prosecution team, which included investigating officers and agents, had no knowledge of the specific documents identified by defendants. The prosecutors therefore had no affirmative duty to discover those documents and to disclose them to defendants.

Defendants are entitled to no relief under *Brady* for one further reason. As our cases have consistently emphasized, the government will not be found to have suppressed material information if that information also was available to a defendant

through the exercise of reasonable diligence. *See United States v. White,* 970 F.2d 328, 337 (7th Cir. 1992); *see also United States v. Rodriguez-Andrade,* 62 F.3d 948, 952 (7th Cir. 1995); *United States v. Dimas,* 3 F.3d 1015, 1018-19 (7th Cir. 1993); *United States v. Hedgeman,* 564 F.2d 763, 768 (7th Cir. 1977), *cert. denied,* 434 U.S. 1070, 55 L. Ed. 2d 773, 98 S. Ct. 1253 (1978). Here, Morris and Gardner knew as much about the OTS, SEC, and IRS investigations as the prosecution team itself did. It appears, for example, that both Morris and Gardner had counsel present during New's OTS deposition. (*See supra,* n.14.) Moreover, that deposition was referenced in New's separate SEC deposition, which defendants admit they possessed prior to trial. Defendants also were involved in litigation with the SEC before the instant prosecution was initiated, and the government established below that the survey of Schnote holders had been available to defendants in connection with that litigation. Where, as here, alleged *Brady* material was available to defendants through the exercise of reasonable diligence, they cannot obtain a new trial by insisting that the government should have conducted their investigation for them. *See United States v. Baker,* 1 F.3d 596, 598 (7th Cir.), *cert. denied,* 126 L. Ed. 2d 359, 114 S. Ct. 412 (1993); *White,* 970 F.2d at 337.

For all of these reasons, we agree with the district court that Morris and Gardner have failed to show that the government "suppressed" the identified information. We need not determine, then, whether that information is favorable to the defense and whether "there is a reasonable probability that, had the evidence been disclosed to the defense, the result of the proceeding would have been different." *Kyles,* 115 S. Ct. at 1565 (internal quotation omitted); *see also Wood v. Bartholomew,* 133 L. Ed. 2d 1, 116 S. Ct. 7, 10 (1995) (*per curiam*).

IV.

Morris and Gardner also challenge the forty-six month prison terms they received under the Sentencing Guidelines. They first contend that the district court erred in calculating the amount of the "loss" under U.S.S.G. § 2F1.1(b)(1). They alternatively argue that the district court should have departed downward to account for other possible causes of the loss here.

A.

Morris and Gardner were assigned a base offense level of six pursuant to U.S.S.G. § 2F1.1(a). Finding that the "estimated, probable or intended loss" from their conduct exceeded $5,000,000, the district court then added eleven points to this base offense level pursuant to section 2F1.1(b)(1)(L).[15] Likening the purchase of a subordinated debt instrument to the issuance of a loan, the court concluded that the actual loss to the victims of defendants' scheme was the face amount of the Schnotes, as the Schnotes were rendered worthless by Germania's demise. That amount, which exceeded $5,000,000 for Schnote purchasers in the Southern District of Illinois, reflected both the loss to the victims as well as the gain to the bank. In settling on that figure, the court rejected defendants' argument that they should not be allocated the entire loss because factors other than their fraud had contributed to Germania's failure. Because the district court's calculation of the amount of loss under section 2F1.1(b)(1) is a finding of fact, we review it only for clear error. *Ross,* Nos. 92-1449 & 92-1685, *slip op.* at 40; *United States v. Johnson,* 16 F.3d 166, 170 (7th

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[15] Because the Guidelines in effect at the time of sentencing would have required a fourteen-level increase for such a loss, the parties and the district court agreed that the version of the Guidelines in effect at the time of the offense would apply to avoid a violation of the Ex Post Facto Clause. *See United States v. Seacott,* 15 F.3d 1380, 1386 (7th Cir. 1994); *United States v. Chevalier,* 1 F.3d 581, 585 n.3 (7th Cir. 1993). We thus refer to the 1987 version of the Guidelines here.

Cir. 1994). The meaning of "loss" in section 2F1.1, however, presents a question of law that we consider de novo. *United States v. Barrett,* 51 F.3d 86, 89 (7th Cir. 1995); *United States v. Holiusa,* 13 F.3d 1043, 1045 (7th Cir. 1994).

Defendants have not contested that the present circumstances can be likened to the more familiar scenario we encounter in fraudulent loan cases. Such cases generally involve a material misrepresentation on a loan application that aids the borrower in procuring a loan. Here, Schnote purchasers effectively loaned to Germania the face value of the Schnotes at a specified rate of interest, and the jury found that these "loans" had been obtained by the bank in connection with a scheme to defraud. In fraudulent loan cases, we define "loss" under section 2F1.1(b)(1) to include the actual or intended loss to the victim, and we have calculated a victim's actual loss by subtracting from the face amount of the loan both the amount repaid prior to discovery of the fraud and any amount to be recovered from assets pledged as collateral to secure the loan. *See, e.g., United States v. Channapragada,* 59 F.3d 62, 66 (7th Cir. 1995); *Johnson,* 16 F.3d at 171-72; *United States v. Chevalier,* 1 F.3d 581, 585-87 (7th Cir. 1993); *United States v. Mount,* 966 F.2d 262, 265 (7th Cir. 1992). This rule has been adopted by the Sentencing Commission in Application Note 7(b), which was added in November 1991, although our decisions pre-dating the application note had employed a similar methodology. *See United States v. Schneider,* 930 F.2d 555 (7th Cir. 1991); *United States v. Miller,* 962 F.2d 739, 748 (7th Cir. 1992) (Flaum, J., concurring); *see also United States v. Kopp,* 951 F.2d 521, 531-36 (3d Cir. 1991) (discussing *Schneider*). Indeed, in *Holiusa,* 13 F.3d at 1047-48, we employed an analogous net loss approach under the version of section 2F1.1 at issue here. *See also Kopp,* 951 F.2d at 535-36. Thus, we agree that such an approach would be an appropriate means of calculating the loss attributable to the fraud of Morris and Gardner.

It turns out, however, that the actual loss in this case is equivalent to the face value of the Schnotes. Germania made no principal payments on the Schnotes prior to its collapse, and because the Schnotes were uninsured, investors recovered nothing thereafter. The actual loss to the victims, then, exceeds $5,000,000.

Defendants argue that they should not be charged with all or even any portion of this loss, however, because factors other than the failure to take recommended reserves in 1987 actually caused Germania's demise. We rejected a similar argument in *United States v. Miller*, 962 F.2d 739 (7th Cir. 1992). There, the defendants had been charged with making false statements in order to obtain mortgage loans insured by the Department of Housing and Urban Development ("HUD"). After procuring the HUD-insured mortgages, the defendants sold the mortgaged buildings to a third party, who eventually defaulted on the mortgages. After purchasing the delinquent loans and acquiring the properties from a successor mortgage company, HUD resold them at a sheriff's sale at a significant loss. *Id.* at 742-43. The defendants argued that HUD's losses were not attributable to their fraud under section 2F1.1(b)(1) because those losses had been caused by the defaulting third party and HUD itself. *Id.* at 743. The *Miller* panel rejected that argument, finding that the defendants' fraud had put HUD's money at risk in the first place. Thus, neither the intervening acts of a negligent third party nor the victim's own failure to mitigate damages could provide a basis for reducing section 2F1.1(b)(1) loss in that circumstance. *Id.* at 744; *see also id.* at 748 (Flaum, J., concurring) ("As noted, however, § 2F1.1(b)(1) loss is measured by the net loss to the injured party"). The existence of other possible causes of the loss could be accounted for only by way of a downward departure pursuant

to Application Note 11. *Id.* at 744, 748-49; *see also United States v. Carey,* 895 F.2d 318, 323 (7th Cir. 1990).[16]

Other circuits have similarly rejected the notion that intervening causes would serve to reduce the amount of loss attributable to a defendant's fraud. *Kopp* observed, for example, that in Application Note 11, the Sentencing Commission, "definitively rejected adjusting the 'loss' itself downward to reflect other causes beyond the defendant's control. . . . To the extent [the] actual loss had other, more proximate causes, a discretionary downward departure--but not a mandatory 'loss' adjustment--might be appropriate." 951 F.2d at 531; *see also, e.g., United States v. Sarno,* 73 F.3d 1470, 1500-01 (9th Cir. 1995); *United States v. Neadle,* 72 F.3d 1104, 1110 (3d Cir. 1995) ("it is not appropriate to reduce the amount of the loss, as computed under the Guidelines, in order to reflect other causes of the loss which were beyond the defendant's control."); *United States v. Shattuck,* 961 F.2d 1012, 1016-17 (1st Cir. 1992) ("The victim loss table in U.S.S.G. § 2F1.1(b)(1) presumes that the defendant alone is responsible

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[16] Under the 1987 version of the Guidelines, that application note provided as follows:

> In a few instances, the total dollar loss that results from the offense may overstate its seriousness. Such situations typically occur when a misrepresentation is of limited materiality or is not the sole cause of the loss. Examples would include understating debts to a limited degree in order to obtain a substantial loan which the defendant genuinely expected to repay; attempting to negotiate an instrument that was so obviously fraudulent that no one would seriously consider honoring it; and making a misrepresentation in a securities offering that enabled the securities to be sold at inflated prices, but where the value of the securities subsequently declines in substantial part for other reasons. In such instances, a downward departure may be warranted.

U.S.S.G. § 2F1.1, App. Note 11 (1987).

for the entire amount of victim loss specified in the particular loss range selected by the sentencing court." (internal quotation omitted)); *see also United States v. Brandon*, 17 F.3d 409, 459 n.83 (1st Cir.), *cert. denied*, 115 S. Ct. 80, 81 (1994).

The Fifth Circuit also rejected an analogous argument made by two former bank officers in *United States v. Stedman*, 69 F.3d 737, 740-41 (5th Cir. 1995). The defendants there had been convicted of removing material information from a bank's loan files in order to make the loans appear healthier to federal regulators. The defendants' scheme had the effect of concealing the bank's true financial condition from regulators and enabling it to postpone loan loss reserves that otherwise would have been required. *Id.* at 739. When their scheme was uncovered after the bank's failure, defendants argued that only those losses directly attributable to their fraud should be considered under the Guideline:

> [Defendants] urge us to hold that the sentencing loss amount should be only that part of the loss for which their illegal conduct was the cause. They maintain that a portion of the loss was unavoidable, that the bank was financially troubled before they concealed information. Accordingly, they conclude that the sentencing court must determine the loss amount for which their wrongful conduct was the sole cause, and use only that amount in sentencing.

Id. at 740 (footnote omitted). The Fifth Circuit disagreed and affirmed the district court's decision to hold the defendants responsible for all losses suffered by the bank on the subject loans. The court explained that the defendants had "exposed the bank to the possibility of loss for the entire loan amount when they chose to impede regulators from considering information that could have led them to intercede to protect the bank." *Id.* at 741.

Under this circuit's *Miller* decision, then, which finds support in the cases of our sister circuits, Morris and Gardner must be held responsible for the total actual loss suffered by the victims of their fraud. The scheme to defraud found by the jury here included a material misrepresentation in the Schnote offering circular as well as the subsequent concealment of material information from the bank's auditors. If the recommendations of the September Analysis had been implemented by Germania, or if they at least had been disclosed to Germania's auditors, it is unlikely that the Schnote offering would have gone forward on the terms that it did. Defendants' scheme therefore facilitated the Schnote offering and caused depositors to put at risk the full value of their investments. In that respect, defendants' conduct here is similar to that of the defendants in *Miller*, as the fraudulent scheme in that case facilitated procurement of the HUD-insured mortgages, which put HUD at risk for the full amount of those mortgages. *See also Sarno,* 73 F.3d at 1501 (all losses on fraudulently-procured loan attributable to the defendant even where the default was not his fault; it was reasonably foreseeable from the defendant's conduct that the loan would be approved, putting the bank's money at risk); *cf. Johnson,* 16 F.3d at 172 (defendant's fraudulent scheme put the bank at risk for the full amount of its loan, although bank suffered no actual loss). Even if defendants' fraud may not have caused Germania's ultimate demise, just as the defendants' fraudulent representations in *Miller* did not actually cause the depreciation in value of the mortgaged property, the existence of intervening causes does not provide a basis for reducing the amount of loss under section 2F1.1(b)(1). *Miller,* 962 F.2d at 744; *see also id.* at 748 (Flaum, J., concurring); *Kopp,* 951 F.2d at 531. The existence of other possible causes of that loss would only provide a basis for a downward departure under the application note. U.S.S.G. § 2F1.1, App. Note 11; *Miller,* 962 F.2d at 744; *Carey,* 895 F.2d at 323.

Defendants argue, however, that *Miller's* intervening cause rule was upset by this circuit's subsequent decision in *United States v. Marlatt,* 24 F.3d 1005 (7th Cir. 1994), which involved a fraud perpetrated against a title insurance company. The defendant in *Marlatt* had procured title insurance policies evidencing clear title for time-share condominium properties by concealing from the insurer that the properties were heavily encumbered by liens for unpaid taxes, judgments, and mortgages. The insurer eventually discovered the defendant's fraud and paid $476,000 to clear the titles. In the meantime, however, the value of the properties had plummeted, and third-party purchasers were threatening the insurer with a fraud suit. To avert that, the insurer decided to buy back the properties at the same price purchasers had paid the defendant--a total of $565,000. *Id.* at 1006; *see also Barrett,* 51 F.3d at 90 (discussing *Marlatt*). The district court included this amount as "loss" under section 2F1.1, but we reversed. By removing the title defects, we explained, the title insurer "had done all that it had promised to do in the insurance policies that it had issued." *Marlatt*, 24 F.3d at 1007. The insurer's subsequent decision to buy the properties back from disgruntled purchasers, we concluded, was not caused by the defendant's fraud and was therefore not chargeable to the defendant as a loss under section 2F1.1:

> Application Note 7(b) distinguishes between loss on the one hand and consequential and incidental damages on the other and makes clear that with irrelevant exceptions the latter two items are not to be counted in computing loss for purposes of sentencing under this guideline. The reason for the distinction is no doubt to prevent the sentencing hearing from turning into a tort or contract suit. The distinction is nicely illustrated by this case. The defendant extracted from [the insurer] by fraud

> a bunch of insurance policies on which Ticor was required to make good to the tune of $476,000. This was the loss. In the wake of the loss, [the insurer] incurred other expenses, which were consequences, perhaps even foreseeable consequences, of the fraud, but were not the thing actually taken from Ticor, the loss; the thing taken was the promise to insure and the cost of honoring that promise was $476,000.

Id. at 1007-08.

This holding, which distinguishes between direct and consequential losses, does not conflict with *Miller's* intervening cause rule. Where defendants' fraud contributed to the victims' decision to put an amount of money at risk, that amount reflects the thing actually taken by the fraud--here, the face value of a Schnote, and in *Marlatt*, the promise to insure against title defects on the subject property. It was defendants' fraud in each case that enabled them to obtain what they needed from their victims. Here, for example, defendants' fraud prevented Schnote purchasers from making an informed investment decision, including an assessment of the likelihood that Germania would be unable to make good on its obligations under the Schnotes. *See Barrett*, 51 F.3d at 91-92. Defendants' scheme also served to conceal the bank's true financial condition from its auditors and federal regulators, either of whom might have interceded to protect the bank and its investors. *See Stedman*, 69 F.3d at 741. Even if intervening forces ultimately contributed to Germania's demise, the thing actually taken from defrauded investors was still the face amount of the Schnotes, and that amount is thus directly charged to defendants under section 2F1.1. That is the import of this circuit's *Miller* decision, which finds consistent support in the law of other circuits. *See also* U.S.S.G. § 2F1.1, App. Note 11 (where a defendant makes misrepresentations in a securities

offering that enable securities to be sold at inflated prices, the loss to the victim is the subsequent loss in value even if attributable in substantial part to other causes). *Marlatt* applies, by contrast, where a victim loses not only the thing actually taken by virtue of the defendant's fraud (i.e., the direct loss), but also suffers consequential or incidental damages. Although a defendant's fraud may be a "but-for" cause of such damages, they are not generally included as loss under section 2F1.1(b)(1). *See* 24 F.3d at 1007-08; *see also Barrett*, 51 F.3d at 91.[17] The present case is controlled by *Miller*, not *Marlatt*. The district court therefore properly interpreted the meaning of "loss" under section 2F1.1 and did not clearly err in estimating the amount of that loss.

B.

Defendants finally contend that the district court erred in refusing to grant them a downward departure to account for other possible causes of the loss charged to them here. Application Note 11 to section 2F1.1 grants to a district court the discretion to depart downward upon finding that the total dollar loss resulting from a defendant's fraud overstates its seriousness, which may be the case "when a misrepresentation is of limited materiality or is not the sole cause of the loss." U.S.S.G. § 2F1.1, App. Note 11; *see also Miller*, 962 F.2d at 744; *Carey*, 895 F.2d at 323. Defendants insist that the district court thought it lacked any authority to depart on this basis, but the record belies defendants' assertion. In denying defendants

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[17] Other circuits have interpreted *Marlatt* in the same way and have agreed that consequential and incidental damages are generally not to be included as loss under section 2F1.1. *See United States v. Gottfried*, 313 U.S. App. D.C. 88, 58 F.3d 648, 651 (D.C. Cir. 1995); *United States v. Daddona*, 34 F.3d 163, 171-72 (3d Cir.), *cert. denied*, 130 L. Ed. 2d 421, 115 S. Ct. 515 (1994); *see also United States v. Newman*, 6 F.3d 623, 630 (9th Cir. 1993); *United States v. Wilson*, 993 F.2d 214, 217 (11th Cir. 1993).

a downward departure at the sentencing hearing, the district court provided the following reasons:

> In this particular case, the application note that you refer to says in a few instances the total dollar loss that results [from] the offense may overstate its seriousness, and I think that's the key word. I have found that the total dollar loss is five million dollars. Now, I have found that that resulted from the offense, and I can't say that that overstates the seriousness of what's happened here.
>
> Keep in mind that we are in a position where we have had a jury find that these defendants were guilty of certain crimes and the only question in front of us now is the application of these guidelines. I don't see how I can make a finding that this overstates the seriousness of the offense. I'm not sure exactly what that means. Certainly, it was a serious offense to the extent that even a small part of the victims lost in excess of five million dollars
>
> . . . .

(July 8, 1994 Tr. at 623.) As these comments illustrate, the district court fully realized that it could depart if it believed that the loss overstated the seriousness of defendants' offense. That is not what the court believed, however, and it therefore denied a departure. This was a discretionary decision that is not subject to review in this court. *See United States v. Reynolds,* 64 F.3d 292, 298 (7th Cir. 1995), *cert. denied,* 133 L. Ed. 2d 890, 116 S. Ct. 969 (1996); *United States v. Gaines,* 7 F.3d 101, 105-06 (7th Cir. 1993).

V.

Having found the evidence sufficient to prove beyond a reasonable doubt the existence of an intentional scheme to defraud, and that Morris and Gardner failed to establish a

violation of the government's *Brady* obligations, we affirm the mail and wire fraud convictions entered on the jury's verdict below. Moreover, we find no merit in defendants' argument that the district court erred in calculating the amount of loss under section 2F1.1 of the Sentencing Guidelines. We therefore also affirm the forty-six month prison sentences imposed below.

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

THE UNITED STATES OF AMERICA,

Plaintiffs,

vs. No. 92-30144

EDWARD L. MORRIS and STEVEN GARDNER,

Defendants.

PRESENT: The Honorable William L. Beatty, Presiding

ATTORNEY FOR PLAINTIFF: Bruce Reppert and Suzanne Wissmann, Assistant United States Attorneys

ATTORNEY FOR DEFENDANT MORRIS: William Lucco and Samuel Ebling

ATTORNEY FOR DEFENDANT GARDNER: Michael Dwyer

Sentencing Hearing
Volume IV
July 8, 1994

THE COURT: I want to clarify one thing here. The question in front of me is not whether Ed Morris and Steve Gardner caused the loss. The jury has settled it. That issue, the jury found that they were guilty of the charges in this indictment, which doesn't have to have a loss, but presumably has at least some nominal loss, so we're not talking about they caused a loss. They have been found to be guilty of the charges in the indictment, and my function then is to determine what the loss was that flowed from that, not whether they caused it or not but what the loss is that flowed from it under *Marlatt*, and I think *Miller*, too.

You criticize the Government for not responding to *Marlatt*. I hadn't heard any talk about *Miller* from the defendants.

MR. LUCCO: Well, my limited research tools look at the best case there is, see how recent it is and see if there is some case that criticizes it, and *Marlatt* I believe is the case law governing this case.

THE COURT: You think the two of them are in conflict?

MR. LUCCO: Yes, a little bit, I do. I don't have that sophistication that [defense consultant] Mr. Newberger has to make that. I don't reconcile them in my own mind, but I know that *Marlatt* was decided last month, and it's a case very much like this case. They are measuring later loss, and they are trying to say did the defendants cause that. That's why I'm troubled when I hear Your Honor say and because of the jury verdict I know [sic] longer have to decide whether Ed Morris and Steve Gardner caused losses, I just have to measure it.

I think there are two things you have to do. I think you do have to decide whether they caused that loss, and I think that's what *Marlatt* tells you, tells us they did not.

THE COURT: Maybe. What I'm saying is I don't have to decide whether there was a fraud or not.

MR. LUCCO: You do not.

THE COURT: I have to decide whether there was a loss.

MR. LUCCO: Then we get back to what Mr. Dwyer and Mr. Newberger have addressed, and that is the Government hasn't shown they caused this loss, they haven't shown it, nor have they shown the measure of it, and you know, if you want to ask us how we're going to do that, I don't know, and I'm glad it isn't my problem, but I don't know. March in all the Schnote holders. The answer is they prove that by whatever test satisfies this Court, but we know there is all kinds of circumstances on an individual basis, like Mr. Newberger was saying, why it's difficult in these class actions, and they are wanting to lump this all together, the Government is taking such a simplistic approach that we add up the dollars of the Schnotes sold in the Southern District and that's by definition the loss. I don't think that's it at all. I think that flies in the face of *Marlatt*, and if you were to even do that, I think you might find under *Marlatt* that's a consequential damage. What we would have had to measure maybe by experts is in March of 1988, Schnote sales are over, loan loss reserves have been backed in, what is the value of the Schnote at that time? In other words, defect titles have been cured, now what's the value of the condo, what's the value of the Schnote, and we don't really have evidence on that, except we know what Laclede did. Laclede did nothing in dealing with Germania, indicating they believed the Schnote had any less value than before. They don't ask for increased interest rates, they asked for no other premium consideration. So I believe, Your Honor that is the curing of the title defects, and the Court is groping about how do we measure its value. We measure it right about then because the loan loss matters are over, the troubled loan portfolio is not over, but that's not what was concealed from anybody. The offering circular and all other documents told the condition of the bank. The only thing concealed was an internal memorandum about the loan, the necessity to take additional loan loss reserves, and I submit

those were taken, and now the title to the condos has been cleared, and we look at the value, and we know the value in this case because it's what Laclede did right then. Novotny told us it was money safe, and they signed the waiver letter, and they extracted nothing from Germania, they did not say now that we know this, you're going to have to pay us another point along the way. They didn't do that, and they can't be characterized as unsophisticated buyers. They were in a good position to value the value of their investment.

THE COURT: I would agree that if your interpretation of *Marlatt* is correct, then the Government hasn't made any proof of what the loss was. I think they would concede that.

MR. LUCCO: Not only have they not made any proof of the loss, then still fundamentally they haven't proved that we caused the loss.

THE COURT: That's probably true too, if your interpretation of *Marlatt* is correct.

MR. LUCCO: I would welcome any opportunity to answer questions about a different interpretation.

THE COURT: Let's talk about *Miller* then.

MR. LUCCO: Let me say first that *Miller* did not interpret *Marlatt*.

THE COURT: Of course *Miller* does not interpret *Marlatt* and *Marlatt* doesn't interpret *Miller*, either, but in *Miller*, don't we have a factual situation that is much more analogous to the *Morris* case than is the *Marlatt* case, and in *Miller*, they are talking about a loan which is what we have here. Germania loaned money, or rather the victims loaned money to Germania.

MR. LUCCO: If I may, Your Honor, you could call that this is a loan and that was a loan, but you can also call this an investment and *Marlatt* was an investment. It was a loan like a CD is a loan or a money market is a loan, those are loans. When I put my money in the bank, and in some kind of an account where I'm getting interest and I'm loaning them my money, and that's what *Miller* is and that's what we had here,

and in *Miller* they say *United States versus Brock* [sic] holds that the total value of fraudulently obtained loans reflects of probable loss resulting from the fraud. The Court found that the defendant's intention to repay the loan was irrelevant. It was enough that he put the lender at risk for the full amount of the loan. Then they hold here that the measure of the loss is the face amount of loan.

Here is why I think *Miller* is not like our case and why *Marlatt* is, because we have a time frame and we have steps to this process, and just like in Ticor, we had defective liens, defective titles caused by liens and encumbrances that had been concealed, Ticor went out and cured those, but the cost of that cure gets assessed and the defendant gets points for us.

* * * *

THE COURT: So that it's again clear, the objections by both defendants consist of objections to the offense level calculation under 2F1.1 and its subsections, the objections to the points for vulnerability of the witness, and to that part of 2F1.1 which speaks in terms of minimal planning, and to the adjustments for the role in the offense, those are the objections, is that correct?

MR. LUCCO: Yes, Your Honor.

MR. DWYER: Yes.

THE COURT: Addressing these objections in the order in which they have been taken up with the evidence, the first one, and obviously the most significant is the amount of the loss. I have reviewed all of the cases cited by counsel. It comes as a surprise to me that, and as confirmed by Mr. Reppert, that there are no cases reported that are arising out of a savings and loan failure that are on all fours factually with this case. And so we therefore must turn to other cases that factually are, in most cases, significantly different.

In any event, I find that the amount of loss for purposes of calculating the guidelines under the provisions of 2F1.1 to be in excess of five million dollars. The object of the fraud in this

case was to in effect secure loans from the purchasers of the Schnotes. I had never thought of this in those terms until I read the *Miller* case and some of the application notes in the guidelines.

In effect, when the Schnote purchasers gave their money to Germania, they were lending them the money, and in return, they were getting in effect a promissory note with certain restrictions and conditions. I didn't think of it before but we usually think in terms of savings and loans lending money to people, but actually they are borrowing money too, in many cases.

Now, the concealment and misrepresentation that was charged in the indictment in this case and of which the defendants were convicted by the jury went — the very heart of it went to the financial soundness of Germania, and therefore the soundness of these loans that the Schnote purchasers made to Germania.

Application note seven defines loss, and this application note is referred to in the *Marlatt* case, defines loss as, quote, the value of the money, property, or services unlawfully taken. Now, in *Marlatt*, the Court equated money, property or services with the promise, the promise to indemnify or to make good the title to the property. In the case that we have in front of us here, we actually have money taken. The fraud resulted in money being taken from the victims. Maybe we have tried to make this thing too complicated. In the face of that application note, there would seem to be no reason to disregard that. It seems very clear, the note says the amount of the money taken. The amount of the money taken is clearly in excess of five million dollars.

Now, *Miller*, I think also is significant, and I don't see a conflict between these two cases. I think it can be squared, and I have tried to, we have two cases, Seventh Circuit, both fairly close together, and I think we have to try to harmonize those cases where we can.

In *Miller*, they talk about the amount of a loan being the face amount of the loan being the amount of the loss. They do not specifically hold that that's the measure of the loss, but they certainly quote cases from other circuits where that has been held, and they also refer to this application note eight, where the guidelines say that you can use the offender's gross gain as the measure of the loss, and of course, in this case, the gross gain was the face amount of the note, which again brings us to something in excess of five million dollars.

I recognize that on this factual situation, it's a case that would appear to be first impression, and I think reasonable minds could certainly differ about interpreting what I think we all agree to be the significant cases, i.e. *Marlatt* and *Miller*. Defendants of course contend that *Marlatt* is less, I mean the defendants contend that *Marlatt* is more significant than *Miller*, and the prosecution contends that *Miller* was the case to follow. I think both of them have to be considered.

With that finding, we have a base offense level of six, which is increased by 11 points which gives us an offense level of 17. In addition, in 2F1.1(b)(2), we have to consider the question if the offense involved, (a), more than minimal planning, (b), a scheme to defraud more than one victim, or (c) a misrepresentation that the defendant was acting on behalf of a charity, educational, religious or political organization, etcetera, we increase the level by two levels. I find that the offense involved here did in fact involve more than minimal planning, and it also obviously involved a scheme to defraud more than one victim. So we have to increase the level by two points.

The next factor to be considered is the question of victim related adjustments, which concerns a question of whether or not the victims were vulnerable as discussed in A1.1. I have given some thought to this particular adjustment. At first impression, when you first think about this case and when I first thought about it in its initial stages, I accepted without

thinking about it that the victims in this case were vulnerable, and there isn't any question that from reading these victim impact statements, certainly some of these people were vulnerable as we use that term in its ordinary sense, but as I read the guidelines and the comments, I'm not too sure that's exactly what the drafters of the guidelines meant. It's clear to me from the evidence in this case and from what we have heard here that there was no intent to target some vulnerable group. As Mr. Gardner expressed it in his very well written statement to the Court, they had to attempt to market these instruments to people who had money, and statistically, you don't have to be a genius to figure out that people who have substantial amounts of money in a CD or who have money in savings and loans are going to be, they are not going to be young kids, they are going to be older people. I don't think we can just make a categorization and say that all senior citizens are unsophisticated or vulnerable. We all know too many of them that aren't. Some are, some aren't. I'm not too sure that at least within the ranges of age that we're talking about here, I'm not too sure that there is any real positive correlation between age and vulnerability. I'm sure we all know many young people who are vulnerable just as we know some older people are vulnerable. In any event, I do not find that there is any adjustment upward warranted for victim related adjustments.

The next calculation and objection we have to consider is that for role in the offense as covered by 3B1.1, an aggravating role. 3B1.1(a) reads if the defendant was an organizer or leader of a criminal activity that involved five or more participants, or was otherwise extensive, increase by four levels. I just think it's almost a given in this case that it was otherwise extensive. This was an extensive operation, without even reaching the question of whether we had five or more participants, and I will assume we didn't have, but we had an operation, a scheme to defraud as found by the jury that was extensive, extensive in that it covered the entire district, that it

extended into Missouri, that it covered all the branches of Germania, that it involved I don't know how many people, certainly a large number of people who were financial consultants who were otherwise involved in marketing these Schnotes, so there is an upward adjustment of four points for that, which if my calculations are correct gives us a total offense level of 23.

All counsel indicated that after the Court had made these findings that they have a brief statement they wanted to make about departures either upward or downward. I'll hear those now. Mr. Reppert?

MR. REPPERT: Your Honor, we don't have anything to add to the record other than what we have previously argued.

THE COURT: Mr. Lucco?

MR. LUCCO: Very briefly, Your Honor, I would cite the Court to application note 11.

THE COURT: Application note 11 in what section?

MR. LUCCO: 2F1.1, provides for circumstances in which there can be a downward departure when the total dollar loss may overstate the seriousness of the fraud, if you will, or where it's not the sole cause of the loss, and look at the last line where the value of the securities subsequently declined in substantial part for other reasons, and I would without belaboring all the arguments and evidence we have adduced and made over the last four days, Your Honor, I would suggest to you that there has been ample evidence of other multiple causations for the ultimate failure of Germania, which resulted in the Schnotes being worthless, and that those matters must be taken into account here. To the extent that the fraud or the concealment of the loan loss circumstances in September of '87 was in my view totally cured by the taking of the loan loss reserves in February of '88, I suggest that that fraud is but a small part in light of the Court's finding, it's but a small part of the total causation of the worthlessness of these Schnotes, so I

would ask the Court to make a significant downward departure pursuant to that application note.

THE COURT: Mr. Dwyer?

MR. DWYER: Your Honor, I would echo Mr. Lucco's remarks and ask also that you refer to application note 11 to the 1987 version of the guidelines which we have been applying here today. The sentencing guidelines have largely eliminated the discretion that you normally had at sentencing, the kind of discretion you exercised when you were on the state court bench and the kind of discretion you exercised when I first became an Assistant Federal Public Defender. Application 11 is a doorway back to the kind of discretion that you had, not totally, but it gives the Court discretion to depart from the guidelines. It doesn't return you to the pre-guideline era, but it gives the Court an opportunity to consider this case in the full context that it's been developed at this sentencing hearing since Tuesday, and throughout the trial.

I think we have established by any measure of certainty that the loss to the Schnote holders had nothing to do with the loan loss reserves taken or not taken in September of 1987. The evidence is overwhelming that the outside world unconnected with Germania gave it a bill of soundness at the end of 1987, and again at the end of 1988. The auditing reports, the bank exams reflected no promise. Anything that might have been a consequence of the failure to take loan loss reserves in September of '87 had long since vanished as a problem by 1990, as the Court earlier said today, the problem loans which are in no way made less a problem by the loan loss reserves were the primary factor in Germania's demise, each and every one of those problem loans was disclosed in the offering circular, and there has been no suggestion otherwise. Whether the Government acted prudently or imprudently in June of 1990, whether the Government acted prudently or imprudently in September of 1987 and beforehand in approving the sale of Schnotes, the Schnote sales had nothing to do with

the demise of Germania. There weren't people coming back into the bank in March of 1988 after Germania had declared losses for year end 1987 and demanding their money back. We have seen absolutely no evidence of that, and there isn't a single assertion of that in the victim impact statements that you have received.

There isn't any question that the amount of the loss here overstates the seriousness of the conduct of these defendants. You have to remember, I think, that they are being punished under the guidelines the same as if they actually put in their own personal pockets the ten million dollars from the Schnote buyers, and took off for parts unknown. They would be treated no differently under 2F1.1 if they had spent the ten million dollars for their own use or burned it or whatever else, and they didn't do that. Maybe putting the money into Germania Bank wasn't a wise investment, but it certainly wasn't for their personal profit, and I think in that regard, among others, the loss here dramatically overstates the seriousness of the offense. These defendants, even had there been no loss, even if the Court had accepted our arguments on the question of loss causation, and on the basis of the Court's other rulings, would be looking at an offense level of 23 minus 11, which is 12, on an offense level of 12, 14, excuse me. My mind, I'm too confused for arithmetic. But they wouldn't be looking at the kind of sentence they are. But they would still be looking at substantial amounts of time, and the Court would have the discretion to give them more than a year, in fact I think it would be required in the guideline range to give them more than a year.

I think that the evidence taken as a whole should lead the Court to accept the guideline's specific invitation to depart, and I would ask the Court to depart dramatically from the guideline range that's established by the Court's conclusion and the offense level of 23 is appropriate here. Thank you.

THE COURT: Mr. Reppert?

MR. REPPERT: Your Honor, in terms of a downward departure, I'm not going to cover the four days of sentencing that we have been through. The Court has heard the evidence. The Government takes the position that there has been no intervening cause, FIRREA didn't cause the loss, Germania was in bad shape, even applying standards pre-FIRREA, and so from that standpoint, we don't see any, at least on that point, we see no reason for a downward departure.

THE COURT: We often hear it said that the Court does still have discretion under the guidelines, discretion essentially to depart upward or downward, but I find usually that that's kind of a false promise, because when you look at the parameters that surround our rights, our discretion to make departures, you will find that there is very little, let's say, wiggle room, left there.

In this particular case, the application note that you refer to says in a few instances the total dollar lost that results in the offense may overstate its seriousness, and I think that's the key word. I have found that the total dollar loss is five million dollars. Now, I have found that that resulted from the offense, and I can't say that that overstates the seriousness of what's happened here.

Keep in mind that we are in a position where we have had a jury find that these defendants were guilty of certain crimes and the only question in front of us now is the application of these guidelines. I don't see how I can make a finding that this overstates the seriousness of the offense. I'm not sure exactly what that means. Certainly, it was a serious offense to the extent that even a small part of the victims lost in excess of five million dollars, those victims where the transactions took place in this district. If I were permitted to depart based on the other things that you talked about, I would have no problem with that.

There is certainly no evidence in this case that these defendants profited in any way by what happened in this case.

To the contrary, the evidence, based on what I have heard here and what I have seen in the pre-sentence report and what I have heard at trial, it's clear that both of these defendants have been ruined financially, just as many of the Schnote purchasers were. There is no evidence in this case that these defendants intended to profit or take the money themselves. You could argue that well, indirectly they would have, because if they got this money and if Germania succeeded, then it would be a going concern, their stock would be worth more money and so on, but there is no evidence that they intended in any way to profit from this.

I think it's particularly significant, the fact that not only did both of the defendants put their own money into this thing, but they put the money of their loved ones into it, too. I think it's significant that many of the things that resulted in the ultimate demise of Germania took place long before either of the defendants in this case arrived on the scene, and to the extent that the actions of the OTS or the RTC may have contributed to the demise of Germania, took place after these defendants had left the scene. But, all of that being true, I do not think that that gives me any legal grounds to depart from the sentence in this case. I am reminded that in a recent Seventh Circuit case, the Court admonished the trial courts that we have to follow the guidelines, the guidelines are the law, and we can't adopt the sentencing practices that we followed prior to the adoption of the guidelines. Specifically, I quote, judges spend their lives penalizing others who depart part from legal norms. Judges are no less bound by the law than those who come before them as litigants. I therefore deny the motion to depart downward.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
CHICAGO, ILLINOIS 60604

May 1, 1996

Before

Honorable WALTER J. CUMMINGS, Circuit Judge
Honorable MICHAEL S. KANNE, Circuit Judge
Honorable ILANA DIAMOND ROVNER, Circuit Judge

No. 94-2740 and 94-2741

UNITED STATES OF AMERICA,	)	Appeal from the
	)	U.S. District
Plaintiff-Appellee,	)	Court for the
	)	Southern District
v.	)	of IL, East
	)	St. Louis Division
EDWARD L. MORRIS AND	)	
STEVEN M. GARDNER,	)	No. 92 CF 30144
	)	
Defendants-Appellants	)	William L. Beatty,
	)	Judge.

ORDER

On consideration of the petition for rehearing with suggestion for rehearing en banc filed by defendants-appellants on April 16, 1996, no judge in active service has requested a vote thereon, and all of the judges on the original panel have voted to deny the petition. Accordingly,

IT IS HEREBY ORDERED that the petition is DENIED.

APPENDIX D

MAIL AND WIRE FRAUD STATUTES (eff. 1987)

§ 1341. Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

§ 1343. Fraud by wire, radio, or television

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

28 U.S.C. § 994. Duties of the Commission

* * * *

(c) The Commission, in establishing categories of offenses for use in the guidelines and policy statements governing the imposition of sentences of probation, a fine, or imprisonment, governing the imposition of other authorized sanctions, governing the size of a fine or the length of a term of probation, imprisonment, or supervised release, and governing the conditions of probation, supervised release, or imprisonment, shall consider whether the following matters, among others, have any relevance to the nature, extent, place of service, or other incidents of an appropriate sentence, and shall take them into account only to the extent that they do have relevance--

(1) the grade of the offense;

(2) the circumstances under which the offense was committed which mitigate or aggravate the seriousness of the offense;

(3) the nature and degree of the harm caused by the offense, including whether it involved property, irreplaceable property, a person, a number of persons, or a breach of public trust;

(4) the community view of the gravity of the offense;

(5) the public concern generated by the offense;

(6) the deterrent effect a particular sentence may have on the commission of the offense by others; and

(7) the current incidence of the offense in the community and in the Nation as a whole.

§ 1B1.3. Relevant Conduct

To determine the seriousness of the offense conduct, all conduct, circumstances, and injuries relevant to the offense of conviction shall be taken into account.

(a) Unless otherwise specified under the guidelines, conduct and circumstances relevant to the offense of conviction means:

> acts or omissions committed or aided and abetted by the defendant, or by a person for whose conduct the defendant is legally accountable, that (1) are part of the same course of conduct, or a common scheme or plan, as the offense of conviction, or (2) are relevant to the defendant's state of mind or motive in committing the offense of conviction, or (3) indicate the defendant's degree of dependence upon criminal activity for a livelihood.

(b) Injury relevant to the offense of conviction means harm which is caused intentionally, recklessly or by criminal negligence in the course of conduct relevant to the offense of conviction.

* * * *

§ 2F1.1. Fraud and Deceit

(a) Base Offense Level: 6

(b) Specific Offense Characteristics

(1) If the estimated, probable or intended loss exceeded $2,000, increase the offense level as follows:

	Loss	Increase in Level
(A)	$2,000 or less	no increase
(B)	$2,001-$5,000	add 1
(C)	$5,001-$10,000	add 2
(D)	$10,001-$20,000	add 3

(E)	$20,001-$50,000	add 4
(F)	$50,001-$100,000	add 5
(G)	$100,001-$200,000	add 6
(H)	$200,001-$500,000	add 7
(I)	$500,001-$1,000,000	add 8
(J)	$1,000,001-$2,000,000	add 9
(K)	$2,000,001-$5,000,000	add 10
(L)	over $5,000,000	add 11

* * * *

Application Note:

8. The amount of loss need not be precise. The court is not expected to identify each victim and the loss he suffered to arrive at an exact figure. The court need only make a reasonable estimate of the range of loss, given the available information. The estimate may be based on the approximate number of victims and an estimate of the average loss to each victim, or on more general factors, such as the nature and duration of the fraud and the revenues generated by similar operations. Estimates based upon aggregate "market loss" (*e.g.*, the aggregate decline in market value of a stock resulting from disclosure of information that was wrongfully withheld or misrepresented) are especially appropriate for securities cases. The offender's gross gain from committing the fraud is an alternative estimate that ordinarily will understate the loss.

* * * *

Background: . . . .

Empirical analyses of current practices show that the most important factors that determine sentence length are the amount of loss and whether the offense is an isolated crime of opportunity or is sophisticated or repeated. Accordingly, although they are imperfect, these are the primary factors upon which the guideline has been based.